CHAPMAN TRIPP

30 April 2019

FROM: Janet Liu
DIRECT: +64 9 357 9178
EMAIL: janet.liu@chapmantripp.com
PARTNER: Penny Sheerin
REF: 041422045/6262430.2

Registrar of Companies
New Zealand Companies Office
Level 18, 135 Albert Street
Auckland 1010

**AMERICAN INCOME LIFE INSURANCE COMPANY – FINANCIAL STATEMENTS FOR FILING UNDER THE FINANCIAL MARKETS CONDUCT ACT 2013**

1 Please find **enclosed** for registration under the Financial Markets Conduct Act 2013 for American Income Life Insurance Company (*AILIC*) for the year ended 31 December 2018:

1.1 AILIC New Zealand Branch Financial Statements and Audit Report, prepared in accordance with New Zealand Generally Accepted Accounting Practice;

1.2 AILIC Group Financial Statements and Audit report, prepared in accordance with Statutory Accounting Principles issued by the National Association of Insurance Commissioners (*US SAP*); and

1.3 the Appointed Actuary's reports prepared in accordance with section 78 of the Insurance (Prudential Supervision) Act 2010 in relation to the Group and Branch Financial Statements above.

2 AILIC gives **notice** to the Registrar of Companies of its reliance on the **enclosed** Financial Markets Conduct (Overseas Registered Banks and Licensed Insurers) Exemption Notice 2016, which exempts AILIC from:

2.1 sections 455(1)(c), 461B, 461D, and 461G of the FMCA; and

2.2 sections 460 and 460 of the FMCA to the extent that those sections require the exempt issuer to ensure that its financial statements, or group financial statements, comply with generally accepted accounting practice,

provided that *inter alia*, it files Group Financial statements that have been prepared and audited in accordance with US SAP.

3 Please charge the registration fee for the financial statements to our account (number 1001971). The reference number you should use is 041422045.

4 We would be grateful if you would confirm registration of these documents as soon as possible.

Yours faithfully

Penny Sheerin / Janet Liu
PARTNER / SOLICITOR

DIRECT: +64 9 357 9178
EMAIL: janet.liu @chapmantripp.com

# American Income Life Insurance Company

Statutory-Basis Financial Statements as of and
for the Years Ended December 31, 2018 and 2017,
Supplemental Schedules as of and for the
Year Ended December 31, 2018, and
Independent Auditors' Report

# AMERICAN INCOME LIFE INSURANCE COMPANY

## TABLE OF CONTENTS

Deloitte.

**Deloitte & Touche LLP**
JPMorgan Chase Tower
2200 Ross Avenue
Suite 1600
Dallas, TX 75201-6778
USA

Tel: +1 214 840 7000
www.deloitte.com

## INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
American Income Life Insurance Company

We have audited the accompanying statutory-basis financial statements of American Income Life Insurance Company (the "Company"), which comprise the statutory-basis statements of admitted assets, liabilities, and capital and surplus as of December 31, 2018 and 2017, and the related statutory-basis statements of operations, changes in capital and surplus, and cash flows for the years then ended, and the related notes to the statutory-basis financial statements.

### Management's Responsibility for the Statutory-Basis Financial Statements

Management is responsible for the preparation and fair presentation of these statutory-basis financial statements in accordance with the accounting practices prescribed or permitted by the Indiana Department of Insurance. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditors' Responsibility

Our responsibility is to express an opinion on these statutory-basis financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the statutory-basis financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the statutory-basis financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the statutory-basis financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the statutory-basis financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the statutory-basis financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

### Basis for Adverse Opinion on Accounting Principles Generally Accepted in the United States of America

As described in Note 1 to the statutory-basis financial statements, the statutory-basis financial statements are prepared by American Income Life Insurance Company using the accounting practices prescribed or permitted by the Indiana Department of Insurance, which is a basis of accounting other than accounting principles generally accepted in the United States of America, to meet the requirements of the Indiana Department of Insurance.

The effects on the statutory-basis financial statements of the variances between the statutory-basis of accounting described in Note 1 to the statutory-basis financial statements and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

**Adverse Opinion on Accounting Principles Generally Accepted in the United States of America**

In our opinion, because of the significance of the matter described in the Basis for Adverse Opinion on Accounting Principles Generally Accepted in the United States of America paragraphs, the statutory-basis financial statements referred to above do not present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of American Income Life Insurance Company as of December 31, 2018 and 2017, or the results of its operations or its cash flows for the years then ended.

**Opinion on Statutory Basis of Accounting**

In our opinion, the statutory-basis financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities, and capital and surplus of American Income Life Insurance Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for the years then ended, in accordance with the accounting practices prescribed or permitted by the Indiana Department of Insurance as described in Note 1 to the statutory-basis financial statements.

**Report on Supplemental Schedules**

Our 2018 audit was conducted for the purpose of forming an opinion on the 2018 statutory-basis financial statements as a whole. The supplemental schedule of investment risk interrogatories, the supplemental summary investment schedule, and the supplemental schedule of selected statutory-basis financial data as of and for the year ended December 31, 2018 are presented for purposes of additional analysis and are not a required part of the 2018 statutory-basis financial statements. These schedules are the responsibility of the Company's management and were derived from and relate directly to the underlying accounting and other records used to prepare the statutory-basis financial statements. Such schedules have been subjected to the auditing procedures applied in our audit of the 2018 statutory-basis financial statements and certain additional procedures, including comparing and reconciling such schedules directly to the underlying accounting and other records used to prepare the statutory-basis financial statements or to the statutory-basis financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, such schedules are fairly stated in all material respects in relation to the 2018 statutory-basis financial statements as a whole.

Deloitte & Touche LLP

April 26, 2019

# AMERICAN INCOME LIFE INSURANCE COMPANY

**STATUTORY-BASIS STATEMENTS OF ADMITTED ASSETS, LIABILITIES, AND CAPITAL AND SURPLUS**
**AS OF DECEMBER 31, 2018 AND 2017**
**(Dollar amounts in thousands, except share and per share data)**

| ADMITTED ASSETS | 2018 | 2017 |
|---|---|---|
| CASH AND INVESTMENTS (Note 2): | | |
| Bonds—at amortized cost (fair value: 2018—$3,399,321; 2017—$3,538,238) | $ 3,333,448 | $ 3,169,004 |
| Preferred stock—at admitted value (fair value: 2018—$39,169; 2017—$39,169) | 39,169 | 39,169 |
| Common stock—affiliated at admitted value (amortized cost: 2018—$14,274; 2017—$14,274) | 41,421 | 38,074 |
| Mortgage Loans | 13,767 | — |
| Real estate occupied by Company—at amortized cost (accumulated depreciation: 2018—$3,946; 2017—$3,730) | 660 | 760 |
| Cash, cash equivalents, and short-term investments | 35,176 | 35,525 |
| Contract loans—secured by cash values | 198,926 | 184,190 |
| Receivables for securities | 4,000 | — |
| Other invested assets, net of encumbrances (2018—$0; 2017—$0) | 150,286 | 135,179 |
| Total cash and investments | 3,816,853 | 3,601,901 |
| INVESTMENT INCOME DUE AND ACCRUED | 54,124 | 51,824 |
| INSURANCE PREMIUMS DEFERRED AND UNCOLLECTED (Note 5) | 202,839 | 203,009 |
| ACCIDENT AND HEALTH PREMIUMS DUE AND UNPAID | 1,725 | 1,623 |
| NET DEFERRED INCOME TAX ASSET (Note 6) | 13,397 | — |
| ELECTRONIC DATA PROCESSING EQUIPMENT (accumulated depreciation: 2018—$1,562; 2017—$1,267) (Note 11) | 912 | 627 |
| RECEIVABLES FROM PARENT, SUBSIDIARIES, AND AFFILIATES (Note 8) | 5,702 | 4,610 |
| OTHER AMOUNTS RECEIVABLE FROM REINSURANCE CONTRACTS—AFFILATED | 54,949 | 50,090 |
| OTHER ADMITTED ASSETS | 6,289 | 6,049 |
| **TOTAL ADMITTED ASSETS** | $ 4,156,790 | $ 3,919,733 |

(Continued)

## AMERICAN INCOME LIFE INSURANCE COMPANY

**STATUTORY-BASIS STATEMENTS OF ADMITTED ASSETS, LIABILITIES, AND CAPITAL AND SURPLUS**
**AS OF DECEMBER 31, 2018 AND 2017**
**(Dollar amounts in thousands, except share and per share data)**

| LIABILITIES AND CAPITAL AND SURPLUS | 2018 | 2017 |
|---|---|---|
| LIABILITIES: | | |
| Aggregate reserves for future policy benefits (Note 4): | | |
| Life | $ 3,335,715 | $ 3,181,150 |
| Accident and health—including unearned premiums of 2018—$5,498; 2017—$5,326 | 120,639 | 113,430 |
| Total aggregate reserves for future policy benefits | 3,456,354 | 3,294,580 |
| Policy and contract claims (Note 4): | | |
| Life | 47,816 | 44,079 |
| Accident and health | 16,017 | 17,475 |
| Other policyholder funds | 89,143 | 89,607 |
| Other amounts payable under reinsurance—affiliated (Note 4) | 70,416 | 59,163 |
| Interest maintenance reserve | 37,328 | 38,371 |
| Asset valuation reserve | 34,742 | 33,493 |
| General insurance expenses and other liabilities | 59,150 | 61,281 |
| Current federal income taxes payable | 1,538 | 9,929 |
| Borrowed funds—affiliated (Note 8) | 277 | 277 |
| Payable to affiliates (Note 7) | 1,039 | 809 |
| Net deferred tax liability (Note 6) | — | 331 |
| Total liabilities | 3,813,820 | 3,649,395 |
| COMMITMENTS AND CONTINGENCIES (Note 10) | | |
| CAPITAL AND SURPLUS (Note 9): | | |
| Common stock, $1 par value per share—authorized 23,360,214 shares; issued and outstanding 11,680,107 shares | 11,680 | 11,680 |
| Paid-in and contributed surplus | 66,889 | 55,000 |
| Surplus notes | 25,000 | 25,000 |
| Aggregate write-ins for special surplus funds | — | — |
| Unassigned surplus | 239,401 | 178,658 |
| Total capital and surplus | 342,970 | 270,338 |
| **TOTAL LIABILITIES AND CAPITAL AND SURPLUS** | $ 4,156,790 | $ 3,919,733 |

See notes to statutory-basis financial statements.

(Concluded)

## AMERICAN INCOME LIFE INSURANCE COMPANY

**STATUTORY-BASIS STATEMENTS OF OPERATIONS**

**FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017**

**(Dollar amounts in thousands)**

| | 2018 | 2017 |
|---|---|---|
| **REVENUE:** | | |
| Premiums | $ 800,680 | $ 811,658 |
| Net investment income (net of expenses of $37,007 in 2018 and $40,100 in 2017) (Note 2) | 166,131 | 150,306 |
| Amortization of interest maintenance reserve | 3,537 | 2,193 |
| Commissions and expense allowances on reinsurance ceded (Note 4) | 175,448 | 161,090 |
| Reserve adjustments on reinsurance ceded (Note 4) | 6,788 | 8,294 |
| Initial reserves on reinsurance assumed (Note 4) | — | 277,467 |
| Miscellaneous income | 1,943 | 1,792 |
| Total revenue | 1,154,527 | 1,412,800 |
| **BENEFITS AND EXPENSES:** | | |
| Death benefits | 152,400 | 142,462 |
| Disability and accident and health benefits (Note 4) | 23,452 | 25,428 |
| Surrender benefits and other fund withdrawals | 60,220 | 57,744 |
| Interest and other benefits on policy and contract funds | 38,306 | 18,780 |
| Increase (decrease) in aggregate reserves for future policy benefits | 187,299 | 484,409 |
| Commissions on premiums | 349,034 | 330,533 |
| Commissions and expense allowances on reinsurance assumed (Note 4) | 147 | 455 |
| General expenses and insurance taxes, licenses, and fees | 135,299 | 124,819 |
| Change in loading on deferred and uncollected premiums (Note 5) | (30,489) | 10,428 |
| IMR adjustment on coinsurance (Note 4) | — | 28,270 |
| Total benefits and expenses | 915,668 | 1,223,328 |
| GAIN FROM OPERATIONS BEFORE FEDERAL INCOME TAXES, DIVIDENDS TO POLICYHOLDERS AND NET REALIZED CAPITAL GAINS (LOSSES) | 238,859 | 189,472 |
| DIVIDENDS TO POLICYHOLDERS | 12 | 12 |
| GAIN FROM OPERATIONS BEFORE FEDERAL INCOME TAXES AND NET REALIZED CAPITAL GAINS (LOSSES) | 238,847 | 189,460 |
| FEDERAL INCOME TAX EXPENSE (BENEFIT) (Note 6) | 47,484 | 45,808 |
| NET GAIN FROM OPERATIONS BEFORE NET REALIZED CAPITAL GAINS (LOSSES) | 191,363 | 143,652 |
| NET REALIZED CAPITAL GAINS (LOSSES)—Net of federal income tax expense (benefit): 2018—$118; 2017—$(5,021),and net gains (losses) transferred to the interest maintenance reserve net of taxes: 2018—$2,495; 2017—$(385) | (667) | (2,121) |
| **NET INCOME** | $ 190,696 | $ 141,531 |

See notes to statutory-basis financial statements.

# AMERICAN INCOME LIFE INSURANCE COMPANY

STATUTORY-BASIS STATEMENTS OF CHANGES IN CAPITAL AND SURPLUS

FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

(Dollar amounts in thousands)

| | 2018 | 2017 |
|---|---|---|
| **CAPITAL AND SURPLUS — Beginning of year** | $ 270,338 | $ 268,847 |
| Net income | 190,696 | 141,531 |
| Change in net unrealized capital gains (losses)—net of tax | 6,655 | (1,333) |
| Change in net unrealized foreign exchange capital gains (losses)—net of tax (Note 12) | (1,229) | 7,047 |
| Change in net deferred income tax (Note 6) | 16,432 | (11,773) |
| Change in nonadmitted assets | (6,758) | (8,249) |
| Change in reserve on account of change in valuation basis | — | — |
| Change in asset valuation reserve | (1,249) | (4,056) |
| Additional capital contributed by parent (Note 8) | 11,889 | — |
| Common stock dividends paid to stockholder (Note 9) | (143,651) | (123,204) |
| Initial commission and expense allowance on reinsurance assumed | (153) | 1,528 |
| Net change in capital and surplus | 72,632 | 1,491 |
| **CAPITAL AND SURPLUS — End of year** | $ 342,970 | $ 270,338 |

See notes to statutory-basis financial statements.

# AMERICAN INCOME LIFE INSURANCE COMPANY

**STATUTORY-BASIS STATEMENTS OF CASH FLOWS**

**FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017**

**(Dollar amounts in thousands)**

| | 2018 | 2017 |
|---|---|---|
| **OPERATING ACTIVITIES:** | | |
| Premiums collected, net of reinsurance | $ 842,497 | $ 804,399 |
| Net Investment income (Note 2) | 184,977 | 164,949 |
| Miscellaneous income | 174,946 | 182,160 |
| Total cash provided by operating activities | 1,202,420 | 1,151,508 |
| Benefits and loss related payments | (267,723) | (227,304) |
| Commissions, expenses paid, and aggregate write-ins for deductions | (484,213) | (455,704) |
| Dividends paid to policyholders | (14) | (18) |
| Federal income taxes (paid) recovered | (54,694) | (29,665) |
| Total cash used in operating activities | (806,644) | (712,691) |
| Net cash provided by (used in) operating activities | 395,776 | 438,817 |
| **INVESTING ACTIVITIES:** | | |
| Proceeds from investments sold, matured or repaid | | |
| Bonds | 80,516 | 62,864 |
| Stock | — | 2,936 |
| Other invested assets | 4 | 708 |
| Total investment proceeds | 80,520 | 66,508 |
| Cost of investments acquired | | |
| Bonds | (275,100) | (294,644) |
| Mortgage Loans | (13,731) | — |
| Real estate | (116) | (16) |
| Other invested assets | (30,273) | (51,289) |
| Miscellaneous applications | — | — |
| Total cost of investments acquired | (319,220) | (345,949) |
| Net increase (decrease) in contract loans | (14,736) | (16,346) |
| Net cash provided by (used in) investing activities | (253,436) | (295,787) |
| **FINANCING AND MISCELLANEOUS SOURCES (USES):** | | |
| Capital and paid in surplus from parent | — | — |
| Borrowed funds | — | (35,000) |
| Net deposits on deposit-type contracts and other insurance liabilities | (458) | 441 |
| Dividends to stockholder | (143,651) | (123,204) |
| Other cash provided (applied) | 1,420 | (4,364) |
| Net cash provided by (used in) financing and miscellaneous sources | (142,689) | (162,127) |

(Continued)

| | | 2018 | | 2017 |
|---|---|---|---|---|
| NET CHANGE IN CASH, CASH EQUIVALENTS, AND SHORT-TERM INVESTMENTS | | (349) | | (19,097) |
| **CASH, CASH EQUIVALENTS, AND SHORT-TERM INVESTMENTS:** | | | | |
| Beginning of year | | 35,525 | | 54,622 |
| End of year | $ | 35,176 | $ | 35,525 |
| | | | | (Concluded) |
| **Supplemental disclosure of non-cash transactions:** | | | | |
| Exchanges of bond investments | $ | 38,978 | $ | 6,669 |
| Non-cash intercompany reinsurance transactions | | — | | 253,388 |
| Parent contributions | | 11,889 | | — |
| Unsettled disposal of other invested assets | | 4,000 | | — |

See notes to statutory-basis financial statements.

## 1. SUMMARY OF SIGNIFICANT STATUTORY ACCOUNTING POLICIES

American Income Life Insurance Company (the "Company" or "American Income"), an insurance company domiciled in the State of Indiana, is a wholly-owned subsidiary of Torchmark Corporation ("Torchmark"). The Company owns 100% of National Income Life Insurance Company, domiciled in the State of New York.

The Company is a life and accident and health insurer licensed in 49 states and the District of Columbia. The Company is also licensed to sell insurance in Canada and New Zealand. The Company is engaged in the marketing, underwriting, and issuance of individual life and supplemental fixed-benefit accident and health insurance. The Company reaches its targeted customers—moderate-income wage earners—through sponsored marketing programs with labor unions, credit unions, and other employment-related associations. In addition, American Income has diversified in recent years by focusing on other affinity groups, third-party internet vendor leads, and referrals. The Company is subject to state insurance regulations and periodic examinations by state insurance departments.

The following states represent the largest concentrations of premiums: California—(11%); Ohio—(8%); Pennsylvania—(5%); Texas—(5%); Illinois—(5%); Florida—(5%); Michigan—(4%); New Jersey—(3%); Wisconsin—(3%); Washington—(3%). No other states represent greater than 3% of total premiums. Canada represents 10% of premiums.

***Basis of Presentation***—The accompanying statutory-basis financial statements have been prepared in accordance with accounting practices prescribed or permitted by the Indiana Department of Insurance (the "Department"). The State of Indiana has adopted the National Association of Insurance Commissioners' (NAIC) statutory accounting principles as the basis of its statutory accounting principles (NAIC SAP), except it has retained the prescribed principles of the Indiana Insurance Code and the Indiana Administrative Code. There are no significant differences between NAIC SAP and the accounting principles prescribed for life and health insurance companies domiciled in the State of Indiana that are applicable to the Company.

NAIC SAP varies in some respects from accounting principles generally accepted in the United States of America (GAAP). The primary differences between statutory-basis and GAAP-basis of accounting include:

| Item | Description | GAAP Treatment | Statutory Treatment |
|---|---|---|---|
| **Policy acquisition costs** | Costs associated with the successful acquisition of an insurance policy | Deferred and amortized over the life of the policy, if recoverable from policy revenues | Charged to operations as incurred |
| **Future policy benefit reserves** | Excess of future policy claims over future premiums | Based on the Company's estimates of mortality, morbidity, interest, persistency, and withdrawals | Based on statutory mortality, morbidity, and interest and withdrawal requirements and reported net of the effects of indemnity reinsurance transactions |
| **Interest maintenance reserve** | Statutory-basis only investment reserve used to account for interest-rate related realized gains and losses | Recognizes capital gains and losses as incurred. | Defers recognition of the realized capital gains and losses resulting from changes in the general level of interest rates and amortizes into income over the expected remaining life of the investments sold |
| **Asset valuation reserve** | Statutory-basis only investment reserve used to account for potential default and equity risks | Not applicable | Required to offset potential credit-related investment losses with changes in the reserve charged to surplus |
| **Deferred premiums** | Portion of premium not currently due | Not recognized | Recognized as an asset on the balance sheet |
| **Nonadmitted assets** | Assets unable to be easily converted to cash | No distinction between admitted and nonadmitted—all assets recorded on the balance sheet | Recognition on the balance sheet disallowed—charged through surplus |
| **Investment in Subsidiaries** | Entity that is directly or indirectly owned and controlled by a reporting entity | Consolidated | Recorded under the equity method of accounting |
| **Investment in Partnerships, Joint Ventures, and LLCs** | Investments that provide partnership interests to the Company | Recorded under the equity method of accounting, or fair value through net income | Recorded under the equity method of accounting |
| **Bonds, preferred stock, and short-term investments** | Fixed income investments for the purpose of collecting interest | Generally carried at fair value | Bonds and short-term investments are generally stated at amortized cost while preferred stock is valued as prescribed by NAIC Securities Valuation Office |
| **Deferred taxes** | An asset or liability on the company's balance sheet due to temporary differences | A provision is made for deferred income taxes on temporary differences between the financial reporting and the tax bases of assets and liabilities | NAIC SAP requires an amount to be recorded for deferred taxes. The amount of deferred income tax assets may not be fully recognized as admitted assets |
| **OCI statement** | Statement of revenues, expenses, gains and losses that have not yet been realized | Required presentation | Not applicable |
| **Cash and Cash Equivalents** | Cash or assets that can be readily converted into cash | Negative balances are reported as a liability | Negative balances are reported within cash |
| **Surplus Notes** | Fixed-income instrument with debt and equity characteristics | Treated the same way as bonds | Generally stated at amortized cost |

Significant accounting practices used in the preparation of the accompanying statutory-basis financial statements are as follows:

***Revenue and Policy Acquisition Cost Recognition***—Premiums are recognized over the premium-paying period of the policies. Unearned premiums on accident and health policies are calculated on a pro-rata basis. Consideration received on deposit-type contracts, which do not contain any life contingencies, is recorded directly to the related liability. Policy acquisition costs, such as commissions and other costs related to successfully acquiring new business, are charged to current operations as incurred.

***Future Policy Benefits***—Aggregate reserves for future policy benefits for individual life and health insurance policies have been provided on either the net level premium method, the commissioner's reserve valuation method, or the two-year preliminary term method. Accordingly, the reserves are calculated based on estimates of mortality, morbidity, and interest and withdrawal requirements, as prescribed by state insurance regulatory agencies. Interest rate assumptions range from 2.3% to 6.0%. For life insurance policies, mortality rates are primarily obtained from the following statutory mortality tables: 1941 S.I., 1961 C.S.I., 1958 C.S.O., 1980 C.S.O., 2001 C.S.O., and 2017 C.S.O. Tables. For health insurance policies, morbidity rates are based primarily on the 1985 NAIC Cancer Claim Cost Tables. Future policy benefit reserves for annuity contracts are based on either the commissioner's annuity reserve valuation method, with appropriate statutory interest and mortality assumptions, or the accumulated contract value. Annuity reserve interest rate assumptions range from 2.5% to 6.0%. Reserves for deposit-type funds are equal to deposits received and interest credited to the benefit of contract holders, less withdrawals that represent a return to the contract holder.

***Policy and Contract Claims***—Policy and contract claims include a provision for reported claims and claims incurred but not reported. The provision for claims incurred but not reported is estimated based on Company experience.

***Federal Income Taxes***—The provision for federal income taxes on operations is based upon taxes that are currently payable. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement book values and tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Deferred tax assets are reduced by valuation allowances when it is determined that it is more likely than not the deferred tax asset will not be fully realized. Realizable deferred tax assets are further subject to admissibility tests performed pursuant to Statement of Statutory Accounting Principles (SSAP) No. 101, *Income Taxes.* The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

***Nonadmitted Assets***—Nonadmitted assets (principally a portion of deferred income tax assets, certain furniture and equipment, agents' debit balances, prepaid expenses, and other amounts receivable) have been charged directly to unassigned surplus.

***Interest Maintenance Reserve (IMR) and Asset Valuation Reserve (AVR)***—The IMR is maintained as prescribed by the NAIC for the purpose of deferring realized gains and losses on the disposal of bonds resulting from changes in the overall level of interest rates. Such realized gains and losses are amortized into income over the approximate remaining life of bonds sold. An AVR is maintained as prescribed by the NAIC for the purpose of providing for default and equity risks related to the Company's invested assets. Changes in the AVR are charged directly to surplus.

***Investments***—Bonds and stock are recorded in accordance with rules promulgated by the NAIC. Bonds eligible for amortization under such rules are reported at amortized cost using the interest method, except for those bonds with a NAIC designation of 6, which are reported at the lower of amortized cost or fair value. Preferred stock of affiliates and nonaffiliates is reported at amortized cost, except for preferred stock with a NAIC designation of 4-6, which is reported at the lower of amortized cost or fair value. Common stock of nonaffiliates is stated at estimated fair value. Common stock of affiliates is stated at their underlying statutory-basis capital and surplus. Contract loans are carried at unpaid principal balance of the loan.

Loan-backed securities are reported at amortized cost, except for those with an NAIC designation of 6, which shall be reported at the lower of amortized cost or fair value. Premiums and discounts on loan-backed bonds and structured securities are amortized using the retrospective method based on anticipated prepayments at the date of purchase. Prepayment assumptions are obtained from broker/dealer survey values or internal estimates. Changes in estimated cash flows from the original assumptions are accounted for using the retrospective method. The Company uses original cost as the basis for applying the retrospective method.

Mortgage loans are reported at unpaid principal balances, net of any unamortized discount or premium and allowance for loan losses. The loans are secured by the underlying real estate.

Real estate, whether held for investment or occupied by the Company, and electronic data processing equipment are valued at cost less accumulated depreciation. Depreciation is calculated using the straight-line method over the estimated useful life of the underlying assets, ranging from 2 to 35 years. Real estate held for sale is valued at the lower of cost less accumulated depreciation or fair value. Real estate held for sale is not depreciated.

Investments in surplus notes are accounted for under rules set forth by the NAIC. Surplus notes rated NAIC 1-2 are reported at amortized cost, and surplus notes rated NAIC 3-6 are reported at the lower of amortized cost and fair value.

***Fair Value Measurements, Investments in Securities***—The investments carried at fair value have been classified, for disclosure purposes, based on a hierarchy defined by SSAP No. 100, *Fair Value Measurements.* The hierarchy consists of three levels to indicate the quality of the fair value measurements as described below:

> *Level 1*—Fair values are based on quoted prices in active markets for identical assets or liabilities that the Company has the ability to access as of the measurement date.
>
> *Level 2*—Fair values are based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability, or inputs that can otherwise be corroborated by observable market data.
>
> *Level 3*—Fair values are based on inputs that are considered unobservable where there is little, if any, market activity for the asset or liability as of the measurement date. In this circumstance, the Company has to rely on values derived by independent brokers or internally-developed assumptions. Unobservable inputs are developed based on the best information available to the Company which may include the Company's own data or bid and ask prices in the dealer market.

The great majority of the Company's bonds are not actively traded and direct quotes are not generally available. Management therefore determines the fair values of these securities after consideration of data provided by third-party pricing services, independent broker/dealers, and other resources.

Approximately 97% of the fair value reported at December 31, 2018 was determined using data provided by third-party pricing services. Prices provided by these services are not binding offers, but are estimated exit values. Third-party pricing services use proprietary pricing models to determine security values by discounting cash flows using a market-adjusted spread to a benchmark yield. For all asset classes within the Company's significant security types, third-party services use a common valuation technique to model the price of the investments using observable market data. The foundation for these models consists of developing yield spreads based on multiple observable market data inputs, including but not limited to: benchmark yield curves, actual trading activity, new issue yields, broker-dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, sector-specific data, economic data, and other inputs that are corroborated in the market. Pricing vendors monitor and review their pricing data continuously with current market and economic data feeds, augmented by ongoing communication within the dealer community.

Using the observable market inputs described above, spreads to an appropriate benchmark yield are further developed by the vendors for each security based on security-specific and/or sector-specific risk factors, such as a security's terms and conditions (coupon, maturity, and call features), credit rating, sector, liquidity, collateral or other cash flow options, and other factors that could impact the risk of the security. Embedded repayment options, such as call and redemption features, are also taken into account in the pricing models. When the spread is determined, it is added to the security's benchmark yield. The security's expected cash flows are discounted using this spread-adjusted yield, and the resulting present value of the discounted cash flows is the evaluated price.

When third-party vendor prices are not available, the Company attempts to obtain valuations from other sources, including but not limited to broker/dealers, broker quotes, and prices on comparable securities.

When valuations have been obtained for all securities in the portfolio, management reviews and analyzes the prices to ensure their reasonableness, taking into account available observable information. When two or more valuations are available for a security and the variance between the prices is 10% or less, the close correlation suggests similar observable inputs were used in deriving the price, and the mean of the prices is used. Securities valued in this manner are classified as Level 2. When the variance between two or more valuations for a security exceeds 10%, additional analysis is performed to determine the most appropriate value for that security, using resources such as broker quotes, prices on comparable securities, recent trades, and any other observable market data. Further review is performed on the available valuations to determine if they can be corroborated within reasonable tolerance to any other observable evidence. If one of the valuations or the mean of the available valuations for a security can be corroborated with other observable evidence, then the corroborated value is used and reported as Level 2. The Company uses information and analytical techniques deemed appropriate for determining the point within the range of reasonable fair value estimates that is most representative of fair value under current market conditions. Valuations that cannot be corroborated within a reasonable tolerance are classified as Level 3.

The Company invests in a portfolio of private placement bonds which are not actively traded. This portfolio is managed by a third party. The portfolio manager provides valuations for the bonds based on a pricing matrix utilizing observable inputs, such as the benchmark treasury rate and published sector indices, and unobservable inputs such as an internally-developed credit rating. If the unobservable inputs can be closely corroborated with publicly available information, the fair values are classified as Level 2. Otherwise, the fair values are classified as Level 3.

NAIC SAP requires certain investments to be measured and reported at fair value. These include common stock, bonds rated NAIC 6 and preferred stock rated NAIC 4-6 whose fair values are less than amortized cost, loan-backed and other structured securities that are reported at fair value as a result of the modified filing exempt (FE) process and surplus notes rated NAIC 3-6 whose fair values are less than amortized cost. Transfers between fair value levels are recognized as of the end of the reporting period in which they occur.

***Fair Value Measurements, Other Financial Instruments***—Fair value of cash, cash equivalents, and short-term investments approximates carrying value. Fair value for the Torchmark preferred stock was obtained from the Securities Valuation Office (SVO). Contract loans are an integral part of the life insurance policies which the Company has in force and, in the Company's opinion, cannot be valued separately. The fair value of investments in limited partnerships that provide low-income housing tax credits is based on discounted projected cash flows. The fair value of limited partnerships in low income housing is considered Level 3.

Other policy holder funds include interest-bearing, deposit-type accounts representing amounts payable on demand. The fair value of such deposit-type accounts is equal to the amount payable on demand and considered Level 2.

Although management is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued for purposes of these financial statements since December 31, 2018 and 2017, and therefore, current estimates of fair value may differ significantly from the amounts presented herein.

***Impairment of Investments***—The Company's portfolio of bonds fluctuates in value due to changes in interest rates in the financial markets as well as other factors. Fluctuations caused by market rate changes have little bearing on whether or not the investment will be ultimately recoverable. Therefore, the Company considers declines in value resulting from changes in market interest rates to be temporary. In certain circumstances, however, the Company determines that the decline in value of a security is other-than-temporary and writes the book value of the security down to fair value, realizing an investment loss. The determination that an impairment is other-than-temporary is highly subjective and involves the careful consideration of many factors.

Among the factors considered are:

- The length of time and extent to which the security has been impaired
- The reason(s) for the impairment
- The financial condition of the issuer and the near-term prospects for recovery in fair value of the security
- The Company's ability and intent to hold the security until anticipated recovery
- Expected cash flows

The relative weight given to each of these factors can change over time as facts and circumstances change. In many cases, management believes it is appropriate to give relatively more weight to prospective factors than to retrospective factors. Prospective factors that are given more weight include prospects for recovery, the Company's ability and intent to hold the security until anticipated recovery, and expected future cash flows.

Among the facts and information considered in the process are:

- Financial statements of the issuer
- Changes in credit ratings of the issuer
- The value of the underlying collateral
- News and information included in press releases issued by the issuer
- News and information reported in the media concerning the issuer
- News and information published or otherwise provided by credit analysts
- The nature and amount of recent and expected future sources and uses of cash
- Default on a required payment
- Issuer bankruptcy filings

While all available information is taken into account, it is difficult to predict the ultimately recoverable amount of a distressed or impaired security.

For asset-backed securities, additional information is gathered and analysis performed on the individual underlying collateral and estimates of potential future collateral performance. Multiple cash flow scenarios are calculated based on various loss rate assumptions and used to assess the likelihood of future possible impairment.

Mortgage loans are considered impaired when it is probable, based upon current information and events, that the Company will be unable to collect all contractual amounts due. Impairment is measured based on the excess of the loan balance over the fair value of the collateral, as determined by a current appraisal, and is recorded as an unrealized loss through a valuation allowance. If an impairment is deemed to be other than temporary, then a direct write-down is recorded as a realized loss, thus establishing a new cost basis equal to the fair value of the collateral less the cost estimated to obtain and sell the property.

The Company's mortgage loan portfolio is managed by an unaffiliated third party. As part of its credit-monitoring process, the third party manager evaluates several risk criteria for each loan. These include quantitative measures, such as the underlying collateral value, loan-to-value ratio, and debt-service coverage ratio, and qualitative risk parameters, such as borrower experience, specific property fundamentals, local real estate market conditions, financial and business condition of the borrower, and ease of liquidation. After consideration of the third party manager's credit analysis, the Company decides if a loan loss allowance should be established.

***Investment Income***—Investment income consists primarily of interest and dividends. Interest is recognized on an accrual basis and dividends are recorded as earned. Interest income on mortgage-backed securities and asset-backed securities is determined on the effective yield method based on estimated principal repayments. Prepayment penalty and acceleration fees on callable bonds are recognized in investment income, as received. Interest earned on contract loans is charged in arrears and recognized ratably.

Realized gains and losses on the sale of investments are determined on a specific identification method. Realized gains and losses on debt securities and preferred stock resulting from an overall change in market interest rates are deferred through the IMR and amortized into income over the remaining expected life of the disposed investment. Credit-related gains and losses on debt securities and preferred stock as well as realized gains and losses on unaffiliated common stock are recorded in the AVR and included in the accompanying statutory-basis statement of operations. Unrealized gains and losses on unaffiliated common stock are also reflected in the AVR. The change in the AVR is reflected as an increase or decrease in surplus. Unrealized gains and losses on affiliated common stock are reflected directly in surplus through the change in unrealized capital gains and losses.

***Cash, Cash Equivalents, and Short-Term Investments***—Cash includes cash on hand and amounts due from banks. The Company considers all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents. Cash equivalents include reverse repurchase agreements, which are secured by bonds and generally mature overnight. The Company's policy requires a minimum of 102% of the agreements' purchase price to be maintained as collateral. The Company does not take possession of this collateral. For further discussion about investments in reverse repurchase agreements, including a description of the underlying collateral as of year-end, please refer to Note 2. The Company considers all investments with remaining maturities (or repurchase dates under repurchase agreements) of one year or less at the time of acquisition (excluding those investments classified as cash equivalents) to be short-term investments, which are stated at amortized cost.

***Reinsurance***—The Company cedes and assumes insurance risks with other companies. Aggregate reserves for future policy benefits, premiums, and expenses are reported after deduction of amounts relating to reinsurance ceded and addition of amounts relating to reinsurance assumed. The Company remains obligated for amounts ceded in the event that the reinsurers do not meet their obligations. Please refer to Note 4 for further discussion.

***Stock Options***—Certain employees of the Company have been granted options to buy shares of Torchmark stock at market value on the grant date under the provisions set forth as part of Torchmark's stock option plans. The Company has no legal obligation under the plans; however, an expense is allocated to the Company based upon the options granted to its employees under the plans, and it is recorded within the General expenses and insurance taxes, licenses, and fees line item within the accompanying statutory-basis financial statements. Excess tax benefits related to the exercise of stock options are recorded as a component of federal income tax expense. The allocated expense for stock compensation recorded during 2018 and 2017 totaled $7,699 and $4,789, respectively.

***Low-Income Housing Tax Credit Interests***—The Company has invested in flow-through entities that provide low-income housing tax credits (LIHTC) and other related federal income tax and state premium tax benefits to the Company. The return on a portion of the Company's investments has been guaranteed by unrelated third parties. The investments are accounted for using the proportional amortized-cost method. The federal income tax benefits accrued during the year are recorded in income tax expense. The premium tax benefits, net of related amortization, are recorded in net investment income. The amount of LIHTC and other tax benefits recognized were $17,162 and $19,907 during 2018 and 2017, respectively.

As of December 31, 2018 and 2017, the LIHTC investment balances were $65,932 and $62,859, respectively. The amounts recorded within other invested assets are presented net of encumbrances for unpaid contributions. As of December 31, 2018 and 2017, unpaid contributions were $27,540 and $23,749, respectively. All of the remaining unpaid contributions are expected to be paid by 2025. Currently, the LIHTC properties are not subject to any regulatory reviews.

The Company's involvement is restricted to its limited partnership interest in the LIHTC entities. The Company has not provided any other financial support to the entities beyond its commitments to fund its limited partnership interests, and there are no arrangements or agreements with any of the interests to provide other financial support. The maximum loss exposure relative to these interests is limited to their carrying value.

As of December 31, 2018, there are 11 years of remaining unexpired tax credits for low-income housing tax credit investments with a required holding period of 16 years, compared to 12 years of remaining unexpired tax credits for low-income housing tax credit investments with a required holding period of 17 years as of December 31, 2017.

***Foreign Currency Translation***—The Company records assets, liabilities, and operations of foreign branches based upon the functional currency of each entity. The determination of the functional currency is made based on the appropriate economic indicators. Assets and liabilities of the foreign branches and subsidiaries are translated from the functional currency to US dollars at the exchange rates in effect at each year-end; and income and expense accounts are translated at the weighted-average exchange rates during the year. The resulting translation adjustments are charged or credited directly to surplus, net of applicable taxes.

***Risk-Based Capital***—The Department has adopted risk-based capital (RBC) requirements for life insurance companies, as promulgated by the NAIC, and these requirements are applicable to the Company. The RBC calculation serves as a benchmark for the regulation of life insurance companies by state insurance regulators. RBC provides for surplus formulas similar to target surplus formulas used by commercial rating agencies. The formulas specify various weighted factors that are applied to statutory-basis financial balances or various levels of activity based on the perceived degree of risk, and are set forth in the RBC requirements. The resulting figure is the authorized control level capital (ACLC).

The RBC guidelines define specific capital levels based on a company's ACLC that are determined by the ratio of a company's total adjusted capital (TAC) to its ACLC. TAC is equal to statutory capital, plus the AVR and any voluntary investment reserves, 50% of dividend liability, and certain other specified adjustments. Companies where TAC is less than or equal to 2.0 times ACLC are subject to certain corrective actions, as set forth in RBC requirements.

At December 31, 2018 and 2017, the statutory TAC of the Company exceeded the level requiring corrective action.

***Use of Estimates***—The preparation of the financial statements in conformity with statutory accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the statutory-basis financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The estimates susceptible to significant change are those used in determining the liability for aggregate reserves for future policy benefits, losses, and claims. Although some variability is inherent in these estimates, management believes the amounts provided are adequate.

***Allocation of Expenses***—The Company operates within a group under their Parent Company, Torchmark, where personnel and facilities are shared. Under terms of the management contract, the subsidiaries of Torchmark are allocated general and administrative expenses based on premium. The allocated amount is in proportion to the Company incurring the expense as if the expense had been paid solely by the Company.

***Subsequent Events***—The Company evaluates events occurring subsequent to the balance sheet date to determine whether the events requires recognition or disclosure in the financial statements. If conditions of a subsequent event were to exist as of the balance sheet date, depending on materiality, the effects may be required to be recognized and disclosed in the financial statements. If conditions of a subsequent event arose after the balance sheet date, the effects are not required to be recognized in the financial statements; however, they may need to be disclosed in the financial statements depending on materiality. We have evaluated subsequent events after the balance sheet date of December 31, 2018 through April 26, 2019, which is the date the statutory basis financial statements were available to be issued, noting no events or transactions that would require recognition or disclosure in the statutory basis financial statements.

(Dollar amounts in thousands except for shares)

## 2. INVESTMENTS

**Analysis of investment operations**—Net investment income for the years ended December 31, 2018 and 2017, is summarized as follows:

| | 2018 | 2017 |
|---|---|---|
| Bonds | $ 170,919 | $ 159,080 |
| Preferred stock—affiliated | 2,671 | 2,671 |
| Common stock—unaffiliated | 23 | 18 |
| Common stock—affiliated | 9,093 | 10,927 |
| Mortgage loans | 569 | — |
| Contract loans | 15,066 | 13,812 |
| Cash, cash equivalents, and short-term investments | 843 | 638 |
| Other invested assets | 3,714 | 2,807 |
| Miscellaneous investment income | 240 | 454 |
| Gross investment income | 203,138 | 190,407 |
| Less investment expenses | 37,007 | 40,101 |
| Net investment income | $ 166,131 | $ 150,306 |

Selected information about disposals of bonds is as follows:

| | At December 31, 2018 | At December 31, 2017 |
|---|---|---|
| **Bonds:** | | |
| Proceeds from sales | $ 19,870 | $ 16,197 |
| Gross realized gains | 1,040 | 1,108 |
| Gross realized losses | (2,605) | — |
| Net gains (losses) on calls and redemptions | $ 2,086 | $ (805) |

The above table includes securities called, redeemed, or otherwise disposed of as a result of a callable feature, which resulted in the receipt of prepayment penalty and acceleration fees. These fees are recorded as investment income at the time of the transaction and are summarized in the following table.

| | At December 31, 2018 | At December 31, 2017 |
|---|---|---|
| **Prepayment Penalty and Acceleration Fees:** | | |
| Number of issues (CUSIPS) called/redeemed | 4 | 5 |
| Investment Income from fees | $ 177 | $ 1,579 |

(Dollar amounts in thousands except for shares)

**Portfolio Composition**—The cost or amortized cost, gross unrealized gains and losses and fair value of bonds and common stock as of December 31, 2018 and 2017, are as follows:

| | 2018 | | | | |
|---|---|---|---|---|---|
| | Book/Adj Carrying Value | Cost or Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| U.S. government | $ 5,027 | $ 5,027 | $ — | $ (19) | $ 5,008 |
| Other government | 19,006 | 19,006 | 1,811 | — | 20,817 |
| Mortgage-backed securities | 74 | 74 | 3 | — | 77 |
| U.S. states, territories, and possessions | 9,014 | 9,014 | 41 | (43) | 9,012 |
| U.S. political subdivisions | 111,033 | 111,033 | 8,431 | (359) | 119,105 |
| U.S. special revenues | 58,030 | 58,030 | 1,879 | (132) | 59,777 |
| Industrial and miscellaneous | 2,978,326 | 2,978,326 | 150,819 | (104,896) | 3,024,249 |
| Asset-backed securities | 30,098 | 30,098 | 412 | (175) | 30,335 |
| Hybrid securities | 122,840 | 122,840 | 10,118 | (2,017) | 130,941 |
| Total bonds | $3,333,448 | $3,333,448 | $ 173,514 | $ (107,641) | $3,399,321 |
| Common stock—unaffiliated | $ 1,204 | $ 99 | $ 1,105 | $ — | $ 1,204 |

| | 2017 | | | | |
|---|---|---|---|---|---|
| | Book/Adj Carrying Value | Cost or Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| U.S. government | $ 3,133 | $ 3,133 | $ — | $ (16) | $ 3,117 |
| Other government | 20,236 | 20,236 | 1,782 | — | 22,018 |
| Mortgage-backed securities | 133 | 133 | 6 | — | 139 |
| U.S. political subdivisions | 44,587 | 44,587 | 2,556 | (76) | 47,067 |
| U.S. special revenues | 74,163 | 74,163 | 10,359 | (7) | 84,515 |
| Industrial and miscellaneous | 2,846,867 | 2,846,867 | 349,448 | (15,319) | 3,180,996 |
| Asset-backed securities | 30,720 | 30,720 | 1,131 | — | 31,851 |
| Hybrid securities | 141,715 | 141,715 | 20,139 | (828) | 161,026 |
| Total bonds | $3,169,004 | $3,169,004 | $ 385,480 | $ (16,246) | $3,538,238 |
| Common stock—unaffiliated | $ 1,032 | $ 99 | $ 933 | $ — | $ 1,032 |

The amortized cost of bonds at December 31, 2018 and 2017includes adjustments for those securities that are other-than-temporarily impaired, if any. The book/adjusted carrying value includes additional adjustments for lower rated securities stated at the lower of amortized cost or fair value. At December 31, 2018 and 2017, the Company did not have any bonds with nonadmitted amounts.

(Dollar amounts in thousands except for shares)

**Bonds by Contractual Maturity**—The book/adjusted carrying value and fair value of bonds at December 31, 2018, by contractual maturity, are shown below. Expected and actual maturities will differ from contractual maturities because the issuers of such bonds may have the right to call or prepay obligations without call or prepayment penalties.

| | Book/Adj Carrying Value | Fair Value |
|---|---|---|
| Due in one year or less | $ 37,528 | $ 37,561 |
| Due after one year through five years | 129,442 | 136,289 |
| Due after five years through ten years | 382,666 | 409,089 |
| Due after ten years | 2,783,812 | 2,816,382 |
| Total | $ 3,333,448 | $ 3,399,321 |

**Other-than-temporary impairments**—During the periods ended December 31, 2018 and 2017, the Company did not write down any individual security holdings to fair value as a result of other-than-temporary impairment.

**Unrealized loss analysis**—The following tables disclose unrealized investment losses by class of investment at December 31, 2018 and 2017. The Company considers these investments to be only temporarily impaired.

**Analysis of Gross Unrealized Investment Losses**
**At December 31, 2018**

| | Less than Twelve Months | | Twelve Months or Longer | | Total | |
|---|---|---|---|---|---|---|
| Description of Securities | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss |
| Bonds: | | | | | | |
| U.S. government | $ 2,772 | $ (16) | $ 2,237 | $ (3) | $ 5,009 | $ (19) |
| Mortgage-backed securities | 21 | — | — | — | 21 | — |
| U.S. states, territories, and possessions | 8,133 | (43) | — | — | 8,133 | (43) |
| U.S. political subdivisions | 3,111 | (20) | 11,282 | (112) | 14,393 | (132) |
| U.S. special revenues | 19,282 | (303) | 15,228 | (56) | 34,510 | (359) |
| Industrial and miscellaneous | 1,159,539 | (63,826) | 324,902 | (41,070) | 1,484,441 | (104,896) |
| Asset-backed securities | 8,556 | (144) | 2,467 | (31) | 11,023 | (175) |
| Hybrid securities | — | — | 7,796 | (2,017) | 7,796 | (2,017) |
| Total unrealized losses | $ 1,201,414 | $ (64,352) | $ 363,912 | $ (43,289) | $1,565,326 | $ (107,641) |

(Dollar amounts in thousands except for shares)

**Analysis of Gross Unrealized Investment Losses**
**At December 31, 2017**

| Description of Securities | Less than Twelve Months Fair Value | Less than Twelve Months Unrealized Loss | Twelve Months or Longer Fair Value | Twelve Months or Longer Unrealized Loss | Total Fair Value | Total Unrealized Loss |
|---|---|---|---|---|---|---|
| Bonds: | | | | | | |
| U.S. government | $ 2,223 | $ (15) | $ 894 | $ (1) | $ 3,117 | $ (16) |
| Mortgage-backed securities | 11 | — | — | — | 11 | — |
| U.S. states, territories, and possessions | — | — | — | — | — | — |
| U.S. political subdivisions | 6,371 | (76) | — | — | 6,371 | (76) |
| U.S. special revenues | 13,929 | (7) | — | — | 13,929 | (7) |
| Industrial and miscellaneous | 106,506 | (1,900) | 127,710 | (13,419) | 234,216 | (15,319) |
| Asset-backed securities | — | — | — | — | — | — |
| Hybrid securities | 22,273 | (95) | 7,767 | (733) | 30,040 | (828) |
| Total unrealized losses | $ 151,313 | $ (2,093) | $ 136,371 | $ (14,153) | $ 287,684 | $ (16,246) |

At December 31, 2018, the Company held 245 issues (CUSIPs) that had been in an unrealized loss position less than 12 months, and 98 issues that had been in an unrealized loss position 12 months or longer. At December 31, 2018 and 2017, the Company's entire bond and equity portfolio consisted of 617 and 547 issues, respectively.

The following table discloses loan-backed and other structured securities that have an unrealized loss as of December 31, 2018 and 2017.

| | Less than Twelve Months Fair Value | Less than Twelve Months Unrealized Loss | Twelve Months or Longer Fair Value | Twelve Months or Longer Unrealized Loss |
|---|---|---|---|---|
| **2018** | $ 11,023 | $ 175 | $ — | $ — |
| **2017** | — | — | — | — |

**Pledged Assets**— The Company had bonds with book/adjusted carrying values of $300,335 and $276,000 on deposit with various state insurance and governmental regulatory agencies as required by law at December 31, 2018 and 2017, respectively.

**Cash Equivalents**—The Company participates in overnight reverse repurchase agreements in which an unaffiliated authorized broker purchases securities and then resells the next day. As of December 31, 2018 and 2017 respectively, the Company had $15,100 and $15,000 in overnight reverse repurchase agreements which were collateralized by the following:

| **2018** | CUSIP | Maturity | Coupon | Par Value | Fair Value with Accrued Interest |
|---|---|---|---|---|---|
| Federal Farm Credit Bank | 31331VWF9 | 4/17/2036 | 5% | $ 8,000 | $ 10,060 |
| Federal Home Loan Bank | 313383YJ4 | 9/8/2023 | 3% | 5,165 | 5,342 |
| | | | | $ 13,165 | $ 15,402 |
| **2017** | | | | | |
| Federal Farm Credit Bank | 3133EHUY7 | 6/17/2030 | 3% | $ 15,763 | $ 15,300 |

(Dollar amounts in thousands except for shares)

**Mortgage loans**—During 2018, the Company began investing in commercial mortgage loan participations. The portfolio consists of participations in transitional real estate loans with three to five year maturities that are originated and serviced by a third-party manager, who also performs credit monitoring and impairment analysis of the loans.

The minimum and maximum lending rates for new mortgage loans were 5.66% and 6.84% during 2018. All new mortgage loans were commercial. The maximum percentage of any one loan to the value of the collateral at the time of the loan was 74.70% during 2018. The Company does not have any significant credit risk exposure to any individual borrower.

The mortgage loan portfolio is invested in a variety of commercial property types located in the United States. As of December 31, 2018, the distribution of the portfolio by property type and geographic location was as follows:

| | 2018 | | 2017 | |
|---|---|---|---|---|
| | Carrying Value | % of Total | Carrying Value | % of Total |
| **Property type:** | | | | |
| Office | $ 4,957 | 36% | $ — | —% |
| Industrial | 4,606 | 33% | — | —% |
| Industrial | 4,204 | 31% | — | —% |
| Total recorded investment | $ 13,767 | 100% | $ — | —% |
| Less valuation allowance | — | — | — | —% |
| Carrying value, net of valuation allowance | $ 13,767 | 100% | $ — | —% |

| | 2018 | | 2017 | |
|---|---|---|---|---|
| | Carrying Value | % of Total | Carrying Value | % of Total |
| **Geographic location:** | | | | |
| West South Central | $ 1,990 | 14% | $ — | —% |
| South Atlantic | 11,777 | 86% | — | —% |
| Total recorded investment | $ 13,767 | 100% | $ — | —% |
| Less valuation allowance | — | — | — | — |
| Carrying value, net of valuation allowance | $ 13,767 | 100% | $ — | —% |

The debt service coverage ratio and the current loan-to-value ratio are considered primary credit quality indicators when evaluating loans for possible impairment. The Company's investment in mortgage loans by credit quality indicator, as of December 31, is as follows:

| | Debt Service Coverage Ratios | | | | |
|---|---|---|---|---|---|
| | <1.00x | 1.00x - 1.20x | >1.20x | Total | % of Total |
| **2018** | | | | | |
| Loan-to-value ratio: | | | | | |
| Less than 70% | $ 4,204 | $ 9,563 | $ — | $ 13,767 | 100% |
| 70% to 80% | — | — | — | — | —% |
| 81% to 90% | — | — | — | — | —% |
| Greater than 90% | — | — | — | — | —% |
| Total | $ 4,204 | $ 9,563 | $ — | $ 13,767 | 100% |

(Dollar amounts in thousands except for shares)

As of December 31, 2018, the Company did not have any mortgage loans that were past due, and none of the loans were considered impaired. The Company did not have any taxes, assessments, or advances that were not included in the mortgage loan total.

**Other Invested Assets**—Other invested assets include surplus notes with an amortized cost of $60,135 and a fair value of $59,459 as of December 31, 2018. All of the Company's surplus notes were rated NAIC 1-2. For this reason, the notes were reported at amortized cost, resulting in no related unrealized losses as of December 31, 2018.

**Affiliated Investments**—As of December 31, 2018 and 2017, the Company had the following subsidiaries:

| | Ownership | Carrying Value[1] | | Subsidiary Assets | | Subsidiary Net Income | |
|---|---|---|---|---|---|---|---|
| | % | 2018 | 2017 | 2018 | 2017 | 2018 | 2017 |
| National Income Life Insurance Company (National Income)............ | 100% | $ 40,217 | $ 37,042 | $270,477 | $233,343 | $ 11,615 | $ 9,083 |
| American Income Marketing Services (AIMS)............................ | 100% | $ 1,203 | $ 1,203 | $ — | $ — | $ — | $ 41 |

(1) The Company's carrying value is presented as the following: National Income at statutory-basis equity and AIMS at its GAAP-basis equity.

National Income declared and paid dividends on its common stock to the Company in the amount of $9,093 and $10,927 during 2018 and 2017, respectively. The Company recorded these amounts in net investment income.

On March 9, 2017, the Company sold Union Heritage Life Assurance Company (UHL) to an unaffiliated third party. Prior to the sale, the Company owned 100% of the outstanding common stock of UHL and recorded a loss of income of $(794) during 2017. See additional information on Note 8.

**Concentrations of Credit Risk**—The financial instruments that subject the Company to concentrations of potential credit risk are primarily bonds, equity securities, short-term investments, and cash on deposit. Such instruments include investments in commercial paper of companies with high credit ratings, investments in money market securities, and investments in securities backed by the United States Government. The Company limits the amount of credit exposure with any one financial issuer or institution and believes that no significant concentration of credit risk exists with respect to the portfolio.

The Company maintains a diversified investment portfolio with limited concentration in any one issuer. Based on admitted value, the portfolio consists of investment-grade corporate securities (77%); contract loans, which are secured by the underlying insurance policy values (5%); municipal bonds, (5%); below investment-grade securities (4%); other invested assets (4%); affiliated stock (2%); cash, cash equivalents, and short-term investments (1%); loan-backed and other structured securities (1%); and other bonds, mortgage loans, receivables for securities, real estate and non-affiliated equities (1%). Excluding investments in affiliates, the Company's largest exposure to a single issuer of debt and equity securities was Johnson Controls International PLC, which represented 1% of cash and invested assets.

Municipal bond investments are made in various states with 35% of the municipal bonds invested in the state of Texas. Corporate debt and equity investments are made in a wide range of industries. At December 31, 2018, the top ten industry concentrations, based on admitted value, were: insurance (12%); electric utilities (11%); pipelines (6%); banks (5%); energy exploration and production (4%); real estate investment trusts (4%); chemicals (4%); transportation (4%); food (4%) and mining (4%).

(Dollar amounts in thousands except for shares)

At December 31, 2018, 4% of cash and invested assets were represented by bonds rated below investment grade by the NAIC (NAIC designations 3–6). Par value of these investments was $157,944, book/adjusted carrying value (or admitted value) was $160,750, and fair value was $143,574. While these investments could be subject to additional credit risk, such risk should generally be reflected in fair value.

## 3. FAIR VALUE OF FINANCIAL INSTRUMENTS

**Investments Measured at Fair Value**—The following tables summarize the investments measured and reported at fair value as of December 31, 2018 and 2017:

| | Fair Value Measurements at December 31, 2018 Using: | | | |
|---|---|---|---|---|
| **Description** | **Quoted Prices in Active Markets for Identical Assets (Level 1)** | **Significant Other Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** | **Total Fair Value** |
| Common stock—industrial and miscellaneous | $ — | $ — | $ 1,204 | $ 1,204 |
| Total | $ — | $ — | $ 1,204 | $ 1,204 |

| | Fair Value Measurements at December 31, 2017 Using: | | | |
|---|---|---|---|---|
| **Description** | **Quoted Prices in Active Markets for Identical Assets (Level 1)** | **Significant Other Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** | **Total Fair Value** |
| Common stock—industrial and miscellaneous | $ — | $ — | $ 1,032 | $ 1,032 |
| Total | $ — | $ — | $ 1,032 | $ 1,032 |

During 2018 and 2017, the Company did not have any transfers between Levels 1 and 2 for assets measured and reported at fair value.

(Dollar amounts in thousands except for shares)

The following table represents changes in assets measured and reported at fair value using significant unobservable inputs (Level 3):

| | Analysis of Changes in Fair Value Measurements Using Significant Unobservable Inputs (Level 3) |
|---|---|
| | Common Stock |
| **Balance at December 31, 2016** | $ 921 |
| Total gains or losses: | |
| Included in net income | — |
| Included in surplus | 111 |
| Purchases | — |
| Issuances | — |
| Sales | — |
| Settlements/amortization | — |
| Transfers into Level 3 | — |
| Transfers out of Level 3 | — |
| **Balance at December 31, 2017** | $ 1,032 |
| Total gains or losses: | |
| Included in net income | — |
| Included in surplus | 172 |
| Purchases | — |
| Issuances | — |
| Sales | — |
| Settlements/amortization | — |
| Transfers into Level 3 | — |
| Transfers out of Level 3 | — |
| **Balance at December 31, 2018** | $ 1,204 |

Included in Level 3 are common stock for which observable market data is not available.

(Dollar amounts in thousands except for shares)

**Fair Value Hierarchy**—The following tables summarize the fair values of all financial instruments by level within the fair value hierarchy as of December 31, 2018 and 2017:

2018

| Type of Financial Instrument | Admitted Value | Aggregate Fair Value | Level 1 | Level 2 | Level 3 | Not Practicable (Carrying Value) | Net Asset Value (NAV) |
|---|---|---|---|---|---|---|---|
| **Assets:** | | | | | | | |
| Bonds | $ 3,333,448 | $ 3,399,320 | $ — | $ 3,295,665 | $ 103,655 | $ — | $ — |
| Preferred stock—affiliated | 39,169 | 39,169 | — | — | 39,169 | — | — |
| Common stock—unaffiliated | 1,204 | 1,204 | — | — | 1,204 | — | — |
| Cash, cash equivalents, and short-term investments | 26,889 | 26,889 | 11,789 | 15,100 | — | — | — |
| Exempt money market mutual funds identified by SVO | 8,287 | 8,287 | — | — | — | — | 8,287 |
| Contract loans | 198,926 | 198,926 | — | — | — | 198,926 | — |
| Mortgage loans[1] | 13,767 | 13,767 | — | — | 13,767 | — | — |
| Other invested assets: | | | | | | | |
| LIHTC partnership interests | 65,932 | 76,905 | — | — | 76,905 | — | — |
| Surplus notes—unaffiliated | 44,964 | 43,877 | — | 43,877 | — | — | — |
| Surplus notes—affiliated | 15,171 | 15,582 | — | — | 15,582 | — | — |
| **Total Assets:** | $ 3,747,757 | $ 3,823,927 | $ 11,789 | $ 3,354,642 | $ 250,282 | $ 198,926 | $ 8,287 |
| **Liabilities:** | | | | | | | |
| Interest bearing deposit-type funds | $ (87,992) | $ (87,992) | $ — | $ (87,992) | $ — | $ — | $ — |
| Borrowed funds—affiliated | (277) | (277) | — | (277) | — | — | — |
| **Total Liabilities:** | $ (88,269) | $ (88,269) | $ — | $ (88,269) | $ — | $ — | $ — |

(Dollar amounts in thousands except for shares)

| 2017 | | | | | | | |
|---|---|---|---|---|---|---|---|
| Type of Financial Instrument | Admitted Value | Aggregate Fair Value | Level 1 | Level 2 | Level 3 | Not Practicable (Carrying Value) | Net Asset Value (NAV) |
| **Assets:** | | | | | | | |
| Bonds | $ 3,169,004 | $ 3,538,238 | $ — | $ 3,438,406 | $ 99,832 | $ — | $ — |
| Preferred stock—affiliated | 39,169 | 39,169 | — | — | 39,169 | — | — |
| Common stock—unaffiliated | 1,032 | 1,032 | — | — | 1,032 | — | — |
| Cash, cash equivalents, and | | | | | | | — |
| short-term investments | 35,525 | 35,525 | 35,525 | — | — | — | — |
| Exempt money market mutual funds identified by SVO | — | — | — | — | — | — | — |
| Contract loans | 184,190 | 184,190 | — | — | — | 184,190 | |
| Mortgage loans[1] | — | — | — | — | — | — | — |
| Other invested assets: | | | | | | | |
| LIHTC partnership interests | 62,859 | 65,507 | — | — | 65,507 | — | — |
| Surplus notes—unaffiliated | 37,001 | 40,552 | — | 40,552 | — | — | — |
| Surplus notes—affiliated | 15,174 | 15,174 | — | 15,174 | — | — | — |
| **Total assets** | $ 3,543,954 | $ 3,919,387 | $ 35,525 | $ 3,494,132 | $ 205,540 | $ 184,190 | $ — |
| **Liabilities:** | | | | | | | |
| Interest bearing deposit-type funds | $ (88,450) | $ (88,450) | $ — | $ (88,450) | $ — | $ — | $ — |
| Borrowed funds—affiliated | (277) | (277) | — | (277) | — | — | — |
| **Total liabilities** | $ (88,727) | $ (88,727) | $ — | $ (88,727) | $ — | $ — | $ — |

[1]The Company invests in mortgage loans with 1 month floating rates. For this reason, the fair value approximates book value.

Contract loans cannot be valued separately from their associated insurance liabilities, thus making the determination of fair value not practicable.

The Company invests in a portfolio of private placement bonds that is managed by a third party. Amortized cost of these bonds was $114,246 and $96,237 as of December 31, 2018 and 2017, respectively. The fair value of those classified as Level 2 was $9,666 and $0 and those classified as Level 3 was $102,990 and $99,832 at December 31, 2018 and 2017, respectively.

(Dollar amounts in thousands except for shares)

## 4. FUTURE POLICY BENEFITS AND REINSURANCE

**Reserves for Life Contracts and Deposit-Type Contracts:**

- The Company waives deduction of deferred fractional premiums upon death of the insured and returns any modal premium paid beyond the date of death. Surrender values are not promised in excess of the legally computed reserves.
- Extra premiums are charges for substandard lives plus the gross premium for a rate age or plus the gross premium for the true age. Mean reserves are determined by computing the regular mean reserve for the plan and in addition, one-half for the extra premium charge for the year for traditional products.
- As of December 31, 2018 and 2017, the Company had insurance in force of $467,629 and $334,611, for which a premium deficiency reserve of $3,595 and $2,270, respectively, was recorded.
- The tabular interest, tabular less actual reserves released, and tabular costs have been determined by formula as prescribed in the NAIC Annual Statement Instructions.
- For the determination of tabular interest on funds not involving life contingencies for each valuation rate of interest, the tabular interest is calculated as one hundredth of the product of such valuation rate of interest multiplied by the mean of the amount of funds subject to such valuation rate of interest held at the beginning and end of the year of valuation.

**Analysis of Annuity Actuarial Reserves and Deposit Liabilities by Withdrawal Characteristics**— The amount of annuity actuarial reserves and deposit-type contract funds and other liabilities without life or disability contingencies as of December 31, 2018 and 2017, were as follows:

| | 2018 | 2017 |
|---|---|---|
| Subject to discretionary withdrawal: | | |
| At book value less current surrender charge of 5% or more | $ 4,163 | $ 4,306 |
| At book value without adjustment | 337,408 | 355,777 |
| Total subject to discretionary withdrawal | 341,571 | 360,083 |
| Not subject to discretionary withdrawal | 708 | 747 |
| Total gross | 342,279 | 360,830 |
| Reinsurance ceded | — | — |
| Total net | $ 342,279 | $ 360,830 |

The following information is obtained from the annual statement, which is filed with the Department. It is provided to reconcile annuity reserves, deposit-type contract funds, and other liabilities without life or disability contingencies to amounts reported in the statutory-basis statements of admitted assets, liabilities, capital and surplus. As of December 31, 2018 and 2017, these amounts were as follows:

| | 2018 | 2017 |
|---|---|---|
| Life and annuity and health annual statement: | | |
| Exhibit 5—annuities section—total (net) | $ 254,209 | $ 272,296 |
| Exhibit 5—supplementary contracts with life contingencies section—total (net) | 78 | 84 |
| Exhibit of deposit-type contracts—column 1, line 14 | 87,992 | 88,450 |
| Total | $ 342,279 | $ 360,830 |

(Dollar amounts in thousands except for shares)

**Change in Incurred Losses and Loss Adjustment Expenses**—The activity in the liability for policy and contract claims for accident and health policies for the years ended December 31, 2018 and 2017, is summarized as follows:

| | 2018 | 2017 |
|---|---|---|
| Balance at January 1—net of reinsurance recoverables | $ 17,475 | $ 16,406 |
| Incurred related to: | | |
| Current year | 25,485 | 26,628 |
| Prior years | (4,604) | (3,673) |
| Total incurred | 20,881 | 22,955 |
| Paid related to: | | |
| Current year | 12,868 | 13,061 |
| Prior years | 9,471 | 8,825 |
| Total paid | 22,339 | 21,886 |
| Balance at December 31—net of reinsurance recoverables | $ 16,017 | $ 17,475 |

The development of prior year claims in 2018 and 2017 reflects normal changes in actuarial estimates.

The balance in the liability for unpaid accident and health claim adjustment expenses as of December 31, 2018 and December 31, 2017 was $384 and $436, respectively.

**Reinsurance Assumed and Ceded**—The Company reinsures the portion of insurance risk in excess of its retention limits to both affiliated and unaffiliated companies. The Company also assumes certain insurance risks of both affiliated and unaffiliated companies. The aggregate reserves for future policy benefits, unearned premiums, policy and contract claims, premiums, and benefits are reported after adding or deducting amounts related to reinsurance assumed or ceded.

The Company reinsures portions of certain life insurance policies that it underwrites to limit certain risks. The Company retains varying amounts of individual insurance up to a maximum retention on any one life of (i) the face amount of the policy if less than $260 or (ii) $250 for all policies having a face amount of $260 or more. Amounts not retained are ceded to Swiss Re Life Insurance Company on an automatic or facultative basis. In addition, certain annual renewable term policies in excess of $50 are ceded to Optimum Re Insurance Company. The Company is not relieved of its primary obligations to the policyholders and is therefore contingently liable in the event that assuming reinsurers are unable to meet their obligations. At December 31, 2018 and 2017, the amount of reserve credits taken for life insurance ceded was $58,647 and $50,863, respectively.

(Dollar amounts in thousands except for shares)

Effective July 1, 2013, the Company entered into a reinsurance agreement with an affiliate, United American Insurance Company (United American). The agreement is on a modified coinsurance basis and the Company cedes to United American, on a 90% quota share basis, the risks on life policies issued in the United States from July 1, 2013 to December 31, 2013. The Company retains, controls, and owns all assets for the modified coinsurance reserve. For the years ended December 31, 2018 and 2017, the Company's statement of operations reflected the following reinsurance adjustments for the reinsurance ceded:

| | 2018 | 2017 |
|---|---|---|
| Premiums ceded | $ 24,779 | $ 26,912 |
| Death benefits ceded | 3,729 | 3,863 |
| Premium taxes ceded | 557 | 605 |
| Commission and expense allowances ceded | 5,767 | 6,278 |
| Reserve adjustments on reinsurance ceded | 6,788 | 8,294 |

Amounts reflected on the accompanying statements of admitted assets, liabilities, and capital and surplus as of December 31, 2018 and 2017 include:

| | 2018 | 2017 |
|---|---|---|
| Uncollected premiums | $ (6,022) | $ (6,523) |
| Reserve adjustments receivable | 1,198 | 1,268 |
| Policy and contract claims recoverable | 741 | 1,121 |
| Commission and expense allowance receivable | 1,536 | 1,666 |

Effective January 1, 2014, the Company entered into a reinsurance agreement with an affiliate, Family Heritage Life Insurance Company of America (Family Heritage). The agreement is on a coinsurance basis and the Company cedes to Family Heritage, on a 50% quota share basis, the risks on life insurance policies issued in the United States on or after the effective date. Effective October 1, 2018, the agreement to assume the business was transferred from Family Heritage to Liberty National Life Insurance Company. For the years ended December 31, 2018 and 2017, the Company's statement of operations reflected the following reinsurance adjustments for the reinsurance ceded:

| | 2018 | 2017 |
|---|---|---|
| Premiums ceded | $ 230,235 | $ 217,688 |
| Death benefits ceded | 23,589 | 14,347 |
| Premium taxes ceded | 5,428 | 4,335 |
| Commission and expense allowances ceded | 169,681 | 154,812 |

Amounts reflected on the accompanying statements of admitted assets, liabilities, and capital and surplus as of December 31, 2018 and 2017 include:

| | 2018 | 2017 |
|---|---|---|
| Premiums ceded payable | $ (64,394) | $ (52,640) |
| Policy and contract claims recoverable | 6,517 | 4,083 |
| Commission and expense allowance receivable | 44,956 | 41,850 |

Effective July 1, 2017, an annuity coinsurance agreement between the Company and its affiliate, United American, was established. The Company is assuming, on a 25% quota share coinsurance basis, all annuity policies in-force as of the effective date, as well as, certain policies issued after the effective date. The Company received an initial ceding commission receivable from United American of $2.4 million. Of the ceding commission received, the Company recognized $822 thousand in income as commissions and expense allowances on reinsurance. The remaining $1.5 million was recorded as an aggregate write-in to surplus and will be amortized into income as the earnings emerge on the reinsured business. The Company assumed reserves of approximately $199.0 million and received assets of approximately $199.0 million from United American for its 25% quota share as of the treaty inception date. Furthermore, the Company received interest-related net gains and losses associated with the transfer of assets backing the reinsured policy liabilities. The transfer resulted in a charge of $18.7 million included in Aggregate Write-ins for Deductions on the Summary of Operations, and a corresponding increase in IMR.

(Dollar amounts in thousands except for shares)

Effective July 1, 2017, a new annuity coinsurance agreement between the Company and its affiliate, Liberty National Life Insurance Company (Liberty National), was established. The Company is assuming, on a 25% quota share coinsurance basis, certain annuity policies in-force as of the effective date, as well as, certain policies issued after the effective date. The Company paid an initial ceding commission payable to Liberty National of $1.1 million. The Company assumed reserves of approximately $78.4 million and received assets of approximately $78.4 million from Liberty National for its 25% quota share as of the treaty inception date. Furthermore, the Company received interest-related net gains and losses associated with the transfer of assets backing the reinsured policy liabilities. The transfer resulted in a charge of $9.6 million included in Aggregate Write-ins for Deductions on the Summary of Operations, and corresponding increase in IMR.

The amounts related to reinsurance assumed and ceded as of and for the years ended December 31, 2018 and 2017, are shown below:

| | 2018 | | 2017 | |
|---|---|---|---|---|
| | **Affiliated** | **Unaffiliated** | **Affiliated** | **Unaffiliated** |
| **Assumed:** | | | | |
| Aggregate reserves for future policy benefits | $ 254,003 | $ — | $ 272,086 | $ — |
| Policy and contract claims unpaid | $ 9,367 | $ — | $ 6,608 | $ — |
| Premiums | $ 5,440 | $ — | $ 2,942 | $ — |
| Incurred benefits | $ 31,667 | $ — | $ 12,586 | $ — |
| Commissions and reinsurance expense allowances | $ 147 | $ — | $ 455 | $ — |
| Reserve adjustment | $ — | $ — | $ — | $ — |
| **Ceded:** | | | | |
| Aggregate reserves for future policy benefits | $ 195,065 | $ — | $ 127,231 | $ — |
| Premiums | $ 255,014 | $ 154 | $ 244,601 | $ 176 |
| Reserve adjustments | $ 6,788 | $ — | $ 8,294 | $ — |
| Incurred benefits | $ 27,319 | $ — | $ 18,209 | $ 380 |
| Premium taxes | $ 5,985 | $ — | $ 4,940 | $ — |
| Commissions and reinsurance expense allowances | $ 175,448 | $ — | $ 161,090 | $ — |

A contingent liability exists with respect to deductions from the aggregate reserves for future policy benefits, policy and contract claims, and unearned premiums, which would become a liability in the event that such reinsurance companies are unable to meet their obligations under the existing reinsurance agreements.

**Ceded Reinsurance Report:**

Section 1—General Interrogatories

- Are any of the reinsurers, listed in Schedule S as nonaffiliated, owned in excess of 10% or controlled, either directly or indirectly, by the Company or by any representative, officer, trustee, or director of the Company?

Yes ( ) No (X)

- Have any of the policies issued by the Company been reinsured with a company chartered in a country other than the United States (excluding U.S. Branches of such companies) which is owned in excess of 10% or controlled directly or indirectly by an insured, a beneficiary, a creditor or an insured or any other person not primarily engaged in insurance business?

Yes ( ) No (X)

Section 2—Ceded Reinsurance Report—Part A

- Does the Company have any reinsurance agreements in effect under which the reinsurer may unilaterally cancel any reinsurance for reasons other than for nonpayment of premium or other similar credits?

Yes ( ) No (X)

- Does the Company have any reinsurance agreements in effect such that the amount of losses paid or accrued through the statement date may result in payment to the reinsurer of amounts which, in aggregate and allowing for offset of mutual credits from other reinsurance agreements with the same reinsurer, exceed the total direct premium collected under the reinsured policies?

Yes ( ) No (X)

Section 3—Ceded Reinsurance Report—Part B

- What is the estimated amount of the aggregate reduction in surplus, for agreements, not reflected in Section 2 above, of termination of all reinsurance agreements, by either party, as of the date of this statement? Where necessary, the Company may consider the current or anticipated experience of the business reinsured in making the estimate.

$0.

- Have any new agreements been executed or existing agreements amended, since January 1 of the year of this statement, to include policies and contracts which were in-force or which had existing reserves established by the Company as of the effective date of the agreement?

Yes ( ) No (X)

(Dollar amounts in thousands except for shares)

## 5. PREMIUM AND ANNUITY CONSIDERATIONS DEFERRED AND UNCOLLECTED

Deferred and uncollected life and health insurance premiums and annuity considerations as of December 31, 2018 and 2017, were as follows:

| | 2018 | | | 2017 | | |
|---|---|---|---|---|---|---|
| | Gross | Loading | Net of Loading | Gross | Loading | Net of Loading |
| Ordinary life new business | $ 14,860 | $ (8,242) | $ 6,618 | $ 89,149 | $ (75,853) | $ 13,296 |
| Ordinary life renewal | 419,878 | (171,664) | 248,214 | 387,081 | (154,758) | 232,323 |
| Group life | 846 | (311) | 535 | 893 | (421) | 472 |
| Assumed annuity-renewal | 1,132 | — | 1,132 | 1,260 | — | 1,260 |
| Ceded life - new business | (6,565) | 3,616 | (2,949) | (40,100) | 34,153 | (5,947) |
| Ceded life - renewal | (91,658) | 40,947 | (50,711) | (69,132) | 30,737 | (38,395) |
| **Total** | $ 338,493 | $ (135,654) | $ 202,839 | $ 369,151 | $ (166,142) | $ 203,009 |
| Nonadmitted (greater than 90 days) | | | — | | | — |
| **Total admitted** | | | $ 202,839 | | | $ 203,009 |

The Company had no direct written premiums from managing general agents in 2018 or 2017.

## 6. INCOME TAXES

### A. Net Deferred Tax Asset/Liability

The components of the net deferred tax asset/(liability) at December 31 are as follows:

| | | December 31, 2018 | | | December 31, 2017 | | | Change | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 1 | | Ordinary | Capital | Total | Ordinary | Capital | Total | Ordinary | Capital | Total |
| (a) | Gross deferred tax assets | $ 178,861 | $ 1,665 | $ 180,526 | $ 157,679 | $ 1,287 | $ 158,966 | $ 21,182 | $ 378 | $ 21,560 |
| (b) | Statutory valuation allowance adjustments | — | — | — | — | — | — | — | — | — |
| (c) | Adjusted gross deferred tax assets | 178,861 | 1,665 | 180,526 | 157,679 | 1,287 | 158,966 | 21,182 | 378 | 21,560 |
| (d) | Deferred tax assets nonadmitted | — | 477 | 477 | — | — | — | — | 477 | 477 |
| (e) | Subtotal net admitted deferred tax asset | 178,861 | 1,188 | 180,049 | 157,679 | 1,287 | 158,966 | 21,182 | (99) | 21,083 |
| (f) | Deferred tax liabilities | 165,464 | 1,188 | 166,652 | 158,438 | 859 | 159,297 | 7,026 | 329 | 7,355 |
| (g) | Net admitted deferred tax asset (net deferred tax liability) | $ 13,397 | $ — | $ 13,397 | $ (759) | $ 428 | $ (331) | $ 14,156 | $ (428) | $ 13,728 |

The Company has not established a statutory valuation allowance in determining its adjusted gross deferred tax assets as management believes that it is more likely than not that all of its gross deferred tax assets will be realized.

(Dollar amounts in thousands except for shares)

2. The amount of admitted adjusted gross deferred tax assets under each component of SSAP No. 101 are presented below.

| | December 31, 2018 | | |
|---|---|---|---|
| | Ordinary | Capital | Total |
| Admission Calculation Components SSAP No. 101 | | | |
| (a) Federal income taxes paid in prior years recoverable through loss carrybacks. | $ — | $ — | $ — |
| (b) Adjusted gross deferred tax assets expected to be realized (excluding the amount of deferred tax assets from 2(a) above) after application of the threshold limitation (The lesser of 2(b)1 and 2(b)2 below). | $ 37,041 | $ — | $ 37,041 |
| 1. Adjusted gross deferred tax assets expected to be realized following the balance sheet date. | $ 37,041 | $ — | $ 37,041 |
| 2. Adjusted gross deferred tax assets allowed per limitation threshold. | XXX | XXX | $ 37,041 |
| (c) Adjusted gross deferred tax assets (excluding the amount of deferred tax assets from 2(a) and 2(b) above) offset by gross deferred tax liabilities. | $ 141,820 | $ 1,188 | $ 143,008 |
| (d) Deferred tax assets admitted as the result of application of SSAP No. 101. Total (2(a) + 2(b) + 2(c)) | $ 178,861 | $ 1,188 | $ 180,049 |

| | December 31, 2017 | | |
|---|---|---|---|
| | Ordinary | Capital | Total |
| Admission Calculation Components SSAP No. 101 | | | |
| (a) Federal income taxes paid in prior years recoverable through loss carrybacks. | $ — | $ — | $ — |
| (b) Adjusted gross deferred tax assets expected to be realized (excluding the amount of deferred tax assets from 2(a) above) after application of the threshold limitation (The lesser of 2(b)1 and 2(b)2 below). | $ 32,111 | $ 1,287 | $ 33,398 |
| 1. Adjusted gross deferred tax assets expected to be realized following the balance sheet date. | $ 32,111 | $ 1,287 | $ 33,398 |
| 2. Adjusted gross deferred tax assets allowed per limitation threshold. | XXX | XXX | $ 33,398 |
| (c) Adjusted gross deferred tax assets (excluding the amount of deferred tax assets from 2(a) and 2(b) above) offset by gross deferred tax liabilities. | $ 125,568 | $ — | $ 125,568 |
| (d) Deferred tax assets admitted as the result of application of SSAP No. 101. Total (2(a) + 2(b) + 2(c)) | $ 157,679 | $ 1,287 | $ 158,966 |

(Dollar amounts in thousands except for shares)

| | Change | | |
|---|---|---|---|
| | Ordinary | Capital | Total |
| Admission Calculation Components SSAP No. 101 | | | |
| (a) Federal income taxes paid in prior years recoverable through loss carrybacks. | $ — | $ — | $ — |
| (b) Adjusted gross deferred tax assets expected to be realized (excluding the amount of deferred tax assets from 2(a) above) after application of the threshold limitation (The lesser of 2(b)1 and 2(b)2 below). | $ 4,930 | $ (1,287) | $ 3,643 |
| 1. Adjusted gross deferred tax assets expected to be realized following the balance sheet date. | $ 4,930 | $ (1,287) | $ 3,643 |
| 2. Adjusted gross deferred tax assets allowed per limitation threshold. | XXX | XXX | $ 3,643 |
| (c) Adjusted gross deferred tax assets (excluding the amount of deferred tax assets from 2(a) and 2(b) above) offset by gross deferred tax liabilities. | $ 16,252 | $ 1,188 | $ 17,440 |
| (d) Deferred tax assets admitted as the result of application of SSAP No. 101. Total (2(a) + 2(b) + 2(c)) | $ 21,182 | $ (99) | $ 21,083 |

3. The following table discloses the calculations for recovery period and threshold limitations.

| | | 2018 | 2017 |
|---|---|---|---|
| (a) | Ratio percentage used to determine recovery period and threshold limitation amount | 668% | 625% |
| (b) | Amount of adjusted capital and surplus used to determine recovery period and threshold limitation | $ 365,654 | $ 304,920 |

4. The following table discloses the impact of tax planning strategies:

| | | December 31, 2018 | | December 31, 2017 | | Change | |
|---|---|---|---|---|---|---|---|
| | | Ordinary Percent | Capital Percent | Ordinary Percent | Capital Percent | Ordinary Percent | Capital Percent |
| (a) | Determination of adjusted gross deferred tax assets and net admitted deferred tax assets, by tax character as a percentage. | | | | | | |
| | 1. Adjusted gross DTAs amount from Note 6A1(c) | $ 178,861 | $ 1,665 | $ 157,679 | $ 1,287 | $ 21,182 | $ 378 |
| | 2. Percentage of adjusted gross DTAs by tax character attributable to the impact of tax planning strategies | —% | —% | —% | —% | —% | —% |
| | 3. Net admitted adjusted gross DTAs amount from Note 6A1(e) | $ 178,861 | $ 1,188 | $ 157,679 | $ 1,287 | $ 21,182 | $ (99) |
| | 4. Percentage of net admitted adjusted gross DTAs by tax character admitted because of the impact of tax planning strategies | —% | 100% | —% | 100% | —% | —% |
| (b) | Does the Company's tax planning strategies include the use of reinsurance? | No | | | | | |

(Dollar amounts in thousands except for shares)

## B. Temporary Differences

There are no temporary differences for which deferred tax liabilities are not recognized.

## C. Deferred Income Taxes

The change in deferred income taxes reported in surplus before consideration of nonadmitted asset is comprised of the following components:

| | December 31, 2018 | | | December 31, 2017 | | | Change | | |
|---|---|---|---|---|---|---|---|---|---|
| | Ordinary | Capital | Total | Ordinary | Capital | Total | Ordinary | Capital | Total |
| Net deferred tax asset (liability) | $ 13,397 | $ 477 | $ 13,874 | $ (759) | $ 428 | $ (331) | $ 14,156 | $ 49 | $ 14,205 |
| Tax-effect of unrealized gains and losses | (7,913) | (645) | (8,558) | (5,847) | (484) | (6,331) | (2,066) | (161) | (2,227) |
| Tax-effect of other surplus gains and losses | — | — | — | — | — | — | — | — | — |
| Net tax-effect without unrealized gains and losses and prior period adjustments | $ 21,310 | $ 1,122 | $ 22,432 | $ 5,088 | $ 912 | $ 6,000 | $ 16,222 | $ 210 | $ 16,432 |

## D. Current income taxes incurred consist of the following major components:

1. Current income tax:

| | December 31, 2018 | December 31, 2017 | Change |
|---|---|---|---|
| a. Federal | $ 47,485 | $ 45,808 | $ 1,677 |
| b. Foreign | — | — | — |
| c. Subtotal | 47,485 | 45,808 | 1,677 |
| d. Federal income tax on net capital gains (losses) | 118 | (5,021) | 5,139 |
| e. Utilization of capital loss carryforwards | — | — | — |
| f. Other | — | — | — |
| g. Federal and foreign income taxes incurred | $ 47,603 | $ 40,787 | $ 6,816 |

(Dollar amounts in thousands except for shares)

2. The tax effects of temporary differences that give rise to significant portions of the deferred tax assets are presented below:

| | December 31, 2018 | December 31, 2017 | Change |
|---|---|---|---|
| (a) Ordinary | | | |
| (1) Discounting of unpaid losses | $ — | $ — | $ — |
| (2) Unearned premium reserve | — | — | — |
| (3) Policyholder reserves | 95,686 | 82,601 | 13,085 |
| (4) Investments | 155 | 106 | 49 |
| (5) Deferred acquisition costs | 74,231 | 66,724 | 7,507 |
| (6) Policyholder dividends accrual | 2 | 3 | (1) |
| (7) Fixed assets | 2,156 | 107 | 2,049 |
| (8) Compensation and benefits accrual | 244 | 244 | — |
| (9) Pension accrual | — | — | — |
| (10) Receivables — nonadmitted | — | — | — |
| (11) Net operating loss carry-forward | — | — | — |
| (12) Tax credit carry-forward | — | — | — |
| (13) Unrealized gains (losses) | 2,318 | 3,081 | (763) |
| (14) Unrealized gains (loss) on foreign exchange | — | — | — |
| (15) Other (including items <5% of total ordinary tax assets) | 4,069 | 4,813 | (744) |
| (99) Subtotal | 178,861 | 157,679 | 21,182 |
| (b) Statutory valuation allowance adjustment | — | — | — |
| (c) Nonadmitted | — | — | — |
| (d) Admitted ordinary deferred tax assets (2a99 - 2b - 2c) | 178,861 | 157,679 | 21,182 |
| (e) Capital: | | | |
| (1) Investments | 1,665 | 1,287 | 378 |
| (2) Net capital loss carry-forward | — | — | — |
| (3) Real estate | — | — | — |
| (4) Other (including items <5% of total capital tax assets) | — | — | — |
| (99) Subtotal | 1,665 | 1,287 | 378 |
| (f) Statutory valuation allowance adjustment | — | — | — |
| (g) Nonadmitted | 477 | — | 477 |
| (h) Admitted capital deferred tax assets (2e99 - 2f - 2g) | 1,188 | 1,287 | (99) |
| (i) Admitted deferred tax assets (2d + 2h) | $ 180,049 | $ 158,966 | $ 21,083 |

(Dollar amounts in thousands except for shares)

3. The tax effects of temporary differences that give rise to significant portions of the deferred tax liabilities are presented below:

| | December 31, 2018 | December 31, 2017 | Change |
|---|---|---|---|
| (a) Ordinary | | | |
| (1) Investments | $ 701 | $ 768 | $ (67) |
| (2) Fixed assets | — | — | — |
| (3) Deferred and uncollected premium | 42,596 | 42,632 | (36) |
| (4) Policyholder reserves | 32,263 | 32,172 | 91 |
| (5) Deferred compensation | — | — | — |
| (6) Agent advances | 79,088 | 73,447 | 5,641 |
| (7) Unrealized gains (loss) on foreign exchange | 10,231 | 8,928 | 1,303 |
| (8) Other (including items <5% of total ordinary tax liabilities) | 585 | 491 | 94 |
| (99) Subtotal | 165,464 | 158,438 | 7,026 |
| (b) Capital: | | | |
| (1) Investments | 261 | 327 | (66) |
| (2) Real estate | — | — | — |
| (3) Unrealized gains (losses) | 645 | 484 | 161 |
| (4) Other (including items <5% of total capital tax liabilities) | 282 | 48 | 234 |
| (99) Subtotal | 1,188 | 859 | 329 |
| (c) Deferred tax liabilities (3a99 + 3b99) | 166,652 | 159,297 | 7,355 |
| Net deferred tax assets/liabilities (2i - 3c) | $ 13,397 | $ (331) | $ 13,728 |

(Dollar amounts in thousands except for shares)

4. On December 22, 2017, the Tax Cuts and Jobs Act (Tax Legislation) was signed into law which revises corporate income tax rates from 35% to 21%, among other modifications. Based on our analysis of the Tax Legislation as of December 31, 2017, the Company was able to determine a reasonable estimate for the tax reform adjustment. The approximate change in the Company's deferred tax asset caused by the tax rate change was $221. Our analysis of the Tax Legislation was completed during the fourth quarter of 2018 resulting in a change to the Company's net deferred taxes of $361 as illustrated below.

-

| | December 31, 2018 | | |
|---|---|---|---|
| | Deferred Taxes at 35% | Deferred Taxes at 21% | Tax Rate Impact |
| Operating Deferred Tax Items | $ 10,933 | $ 6,560 | $ 4,373 |
| Unrealized Deferred Tax Items | (10,581) | (6,348) | (4,233) |
| Total Deferred Tax Items | $ 352 | $ 212 | $ 140 |

| | December 31, 2017 | | |
|---|---|---|---|
| | Deferred Taxes at 35% | Deferred Taxes at 21% | Tax Rate Impact |
| Operating Deferred Tax Items | $ 9,999 | $ 6,000 | $ 3,999 |
| Unrealized Deferred Tax Items | (10,550) | (6,330) | (4,220) |
| Total Deferred Tax Items | $ (551) | $ (330) | $ (221) |

| | Change | | |
|---|---|---|---|
| | Deferred Taxes at 35% | Deferred Taxes at 21% | Tax Rate Impact |
| Operating Deferred Tax Items | $ 934 | $ 560 | $ 374 |
| Unrealized Deferred Tax Items | (31) | (18) | (13) |
| Total Deferred Tax Items | $ 903 | $ 542 | $ 361 |

(Dollar amounts in thousands except for shares)

## E. Book to Tax adjustments

Among the more significant book to tax adjustments were the following:

| | December 31, 2018 | December 31, 2017 | Change |
|---|---|---|---|
| (1) Current income taxes incurred | $ 47,603 | $ 40,787 | $ 6,816 |
| (2) Change in deferred income tax (without tax on unrealized gains and losses and surplus adjustments) | (16,432) | 11,773 | (28,205) |
| (3) Total income tax reported | $ 31,171 | $ 52,560 | $ (21,389) |
| (4) Net gain from operations before federal income tax and realized gains. | $238,847 | $189,459 | $ 49,388 |
| (5) Realized capital gains (losses) before federal income tax, after transfer to IMR | (549) | (7,142) | 6,593 |
| (6) Income before taxes | 238,298 | 182,317 | 55,981 |
| | 21% | 35% | (14)% |
| Expected income tax expense (benefit) at statutory rate | 50,043 | 63,811 | (13,768) |
| (7) Increase (decrease) in actual tax reported resulting from: | | | |
| a. Dividends received deduction | (2,472) | (4,760) | 2,288 |
| b. Adjustment for equity in subsidiaries | — | — | — |
| c. Nondeductible expenses for meals, penalties, and lobbying | 107 | 113 | (6) |
| d. Tax-exempt income | (230) | 14 | (244) |
| e. Tax adjustment for IMR | (219) | 8,992 | (9,211) |
| f. Employee stock options | (320) | (1,286) | 966 |
| g. Deferred tax benefit on nonadmitted assets | (1,319) | (2,873) | 1,554 |
| h. Tax credits | (14,700) | (14,174) | (526) |
| i. Prior year adjustments | (46) | (24) | (22) |
| j. IRS interest refund | — | — | — |
| k. Tax Reform | 374 | 3,999 | (3,625) |
| l. Sale of UHL | — | (2,115) | 2,115 |
| m. Other | (47) | 863 | (910) |
| (8) Total income tax reported | $ 31,171 | $ 52,560 | $ (21,389) |

## F. Federal Taxes

1. As of December 31, 2018, the Company has no net operating loss or tax credit carryforwards. As of December 31, 2018 and 2017, the Company has no net operating loss or tax credit carryforwards.

2. The amount of Federal income taxes incurred that are available for recoupment in the event of future net losses are as follows:

| | | |
|---|---|---|
| 2018 | $ | 41 |
| 2017 | $ | — |
| 2016 | $ | — |

The aggregate amount of deposits admitted under Section 6603 of the Internal Revenue Code is $0 and $0 at December 31, 2018 and 2017, respectively.

**G. Consolidated Federal Income Tax Return**

The Company's federal income tax return is consolidated with its ultimate parent, Torchmark, as well as its affiliated subsidiaries including: Liberty National Life Insurance Company, Globe Life Insurance Company of New York, Family Heritage Life Insurance Company of America, Globe Life And Accident Insurance Company, United American Insurance Company, National Income Life Insurance Company, TMK Buildings Corporation, Brown Service Funeral Homes Company, Inc., Torchmark Insurance Agency, Inc., Specialized Advertising Group, Inc., Globe Marketing Services, Inc., AILIC Receivables Corporation, American Income Marketing Services, Inc., Liberty National Auto Club, Inc., Globe Life Insurance Agency, Inc., and TMK Re, Ltd.

Each company pays a share of the total tax liability determined as if computed separately. Companies that would report a loss are reimbursed to the extent that their losses are utilized by affiliates with taxable income. The calculation is made pursuant to Federal Income Tax Regulation 1.1552-1(a)(2) and 1.1502-33(d)(3)(ii).

The Company's income tax returns are routinely audited by the Internal Revenue Service (IRS). The statute of limitation for the assessment of additional tax is closed for all tax years prior to 2015. Management believes that adequate provision has been made in the statutory-basis financial statements for any potential assessments that may result from the completed examinations, future tax examinations, and other tax-related matters for all open tax years.

The Company currently does not have any tax contingencies that are required to be recognized in accordance with SSAP No. 5R, *Liabilities, Contingencies and Impairments of Assets.*

**H. Repatriation Transition Tax (RTT)**

The Company does not owe RRT for the year.

**I. Alternative Minimum Tax (AMT) Credit**

The Company had no AMT credit carryforwards as of the beginning of the year. As a result, no AMT credits were recovered during the year or exist as of the end of the year.

**J. Tax Penalties**

The Company's continuing practice is to recognize interest and/or penalties related to income tax matters in income tax expense. The Company recognized interest income of $0 and $0, net of federal income tax benefits, in its statutory-basis Statement of Operations for 2018 and 2017, respectively. The Company does not have any accrued interest receivables and/or payables relating to prior year IRS examination settlements as of December 31, 2018 and 2017. The Company had no accrued penalties as of December 31, 2018 and 2017.

(Dollar amounts in thousands except for shares)

## 7. EMPLOYEE BENEFIT PLANS

**Defined Benefit Pension Plans**—The Company has a funded noncontributory defined benefit plan for all hourly employees who have completed one year of service with the Company. Certain assets of the Company in the form of a guaranteed investment contract in the amount of $26,504 and $21,202 were allocated in 2018 and 2017, respectively, to pay future benefits. The benefits are set as a monthly amount for each year of service with the Company. Cost for the plan has been calculated on the projected unit credit actuarial cost method. Contributions are made periodically to fund plan obligations. All plan measurements are as of December 31 of the respective year.

The information about the Company's defined benefit pension plan as of December 31, 2018 and 2017, is as follows:

| | 2018 | 2017 |
|---|---|---|
| Accumulated benefit obligation | $ 34,542 | $ 34,480 |
| Projected benefit obligation | 34,542 | 34,480 |

**Fair Value Measurements at December 31, 2018**

| Description for each class of plan assets | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Unallocated insurance contract | $ — | $ 26,504 | $ — | $ 26,504 |

**Fair Value Measurements at December 31, 2017**

| Description for each class of plan assets | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Unallocated insurance contract | $ — | $ 21,202 | $ — | $ 21,202 |

The following table discloses the assumptions used to determine the Company's pension liabilities and costs for the appropriate periods. The discount rate is used to determine projected benefit obligations and pension expense. The discount rate is determined based on the expected duration of plan liabilities. A yield is then derived based on the current market yield of a hypothetical portfolio of higher-quality corporate bonds which match the liability duration. Differences between assumptions and actual experience are included in actuarial gain or loss.

| Weighted Average Pension Plan Assumptions | 2018 | 2017 |
|---|---|---|
| For benefit obligations — December 31 — discount rate | 4.33% | 3.74% |
| For periodic benefit cost for the year: | | |
| Discount rate | 3.74 | 4.14 |
| Expect long-term rate of return | 6.25 | 6.25 |
| Rate of compensation increase(1) | N/A | N/A |

(1) The Company does not project a benefit obligation since the benefit formula for the plan does not contain a salary component.

(Dollar amounts in thousands except for shares)

The following table presents the components of net periodic pension cost as of December 31, 2018 and 2017, for the defined benefit pension plan:

| | 2018 | 2017 |
|---|---|---|
| Service cost | $ 1,641 | $ 1,500 |
| Interest cost | 1,346 | 1,222 |
| Expected return on assets | (1,441) | (1,226) |
| Amortization of prior service cost | 535 | 476 |
| Amortization of net loss | 429 | 423 |
| Net periodic benefit cost | $ 2,510 | $ 2,395 |

The following table presents a reconciliation at December 31, 2018 and 2017, from the beginning to the end of the year of the accumulated benefit obligation of the defined benefit pension plan:

| | 2018 | 2017 |
|---|---|---|
| **Changes in benefit obligation:** | | |
| Obligation—balance at January 1 | $ 34,480 | $ 29,739 |
| Service cost | 1,641 | 1,500 |
| Interest cost | 1,346 | 1,222 |
| Actuarial (gain) loss | (4,808) | 2,422 |
| Benefits paid | (494) | (403) |
| Plan amendments | 2,377 | — |
| Obligation—balance at December 31 | 34,542 | 34,480 |
| **Changes in plan assets:** | | |
| Plan assets—fair value at January 1 | 21,202 | 18,997 |
| Return on assets | 920 | 822 |
| Contributions | 4,876 | 1,786 |
| Benefits paid | (494) | (403) |
| Plan assets—fair value at December 31 | 26,504 | 21,202 |
| Funded status at December 31 | $ (8,038) | $ (13,278) |

The portion of unassigned surplus that is expected to be reflected in pension expense in 2019 is as follows:

| | Defined Benefit Plan |
|---|---|
| Amortization of prior service cost | $ 631 |
| Amortization of net loss | 161 |
| Total | $ 792 |

(Dollar amounts in thousands except for shares)

The following table illustrates the estimated pension benefit payments, which reflect the expected future service that is projected to be paid:

| | Defined Benefit Plan |
|---|---|
| 2019 | $ 683 |
| 2020 | 791 |
| 2021 | 912 |
| 2022 | 1,052 |
| 2023 | 1,210 |
| 2024–2028 | 8,466 |

Cost for the defined benefit pension plan has been calculated on the projected unit credit actuarial cost method. All plan measurements for the defined benefit plans are as of December 31 of the respective year. The defined benefit pension plan covering the hourly employees is funded. Contributions are made to fund the plan subject to minimums required by regulations and maximums allowed for tax purposes. Defined benefit plan contributions were $4,876 in 2018 and $1,786 in 2017. The Company does not have any regulatory contribution requirements for 2018, however, the Company currently intends to make voluntary contributions of $1,700 in 2019. The actual amount of the contribution may be different from this estimate.

In January 2007, Torchmark approved and implemented a new Supplemental Executive Retirement Plan (SERP), which provides an additional supplemental defined pension benefit to a limited number of executives. The supplemental benefit is based on the participant's qualified plan benefit without consideration to the regulatory limits on compensation and benefit payments applicable to qualified plans, except that eligible compensation is capped at $1 million.

The Company's liability to this plan was $1,619 and $2,377 at December 31, 2018 and 2017, respectively. Pension cost is determined in the same manner as the defined benefit plans. Expense recognized for the plan was $190 and $225 for the years ended December 31, 2018 and 2017, respectively.

**Defined Contribution Plans**—In addition to the defined benefit plans, the Company has a qualified 401(k) and profit sharing plan for its exempt employees. The Company makes annual contributions to the plan of six percent of each employee's compensation, subject to limitation. All Company contributions are subject to a vesting schedule based on the employee's years of service. For the years ended December 31, 2018 and 2017, Company contributions totaled $768 and $703, respectively.

**Postretirement Benefit Plans Other Than Pension**—The Company does not provide postretirement employment benefits to its employees other than those described above, except certain executive officers are covered by a post-retirement life insurance plan sponsored by Torchmark. The Company was allocated $(183) and $19 for 2018 and 2017, respectively, for its annual share of the plan. The Company's liability under this plan was $0 and $0 as of December 31, 2018 and 2017, respectively.

(Dollar amounts in thousands except for shares)

## 8. INFORMATION CONCERNING PARENT, SUBSIDIARIES, AND AFFILIATES

**Summary of Transactions**—A summary of transactions between the Company and its parent, subsidiary and affiliates as of and for the years ended December 31, 2018 and 2017, is as follows:

| | 2018 | | | |
|---|---|---|---|---|
| | Receivable | Payable | Revenue | Expense |
| National Income Life Insurance Company | $ 3,436 | $ — | $ 7,529 | $ — |
| United American Insurance Company | 10 | — | 34 | 76 |
| Globe Life And Accident Insurance Company | 172 | 748 | — | 1,312 |
| Liberty National Life Insurance Company | 36 | — | 83 | 325 |
| Torchmark Corporation | 12 | — | 2,730 | 20,376 |
| AILRC | — | 568 | 1,610 | 15,607 |
| Family Heritage Life Insurance Company of America | 36 | — | 794 | — |
| AIMS | 2,000 | — | | — |
| | $ 5,702 | $ 1,316 | $ 12,780 | $ 37,696 |

| | 2017 | | | |
|---|---|---|---|---|
| | Receivable | Payable | Revenue | Expense |
| National Income Life Insurance Company | $ 2,400 | $ — | $ 5,400 | $ — |
| United American Insurance Company | 11 | 1 | | 1,234 |
| Globe Life And Accident Insurance Company | 135 | 786 | | 1,041 |
| Liberty National Life Insurance Company | 33 | — | | 105 |
| Torchmark Corporation | — | 18 | 2,768 | 15,811 |
| Union Heritage Life Insurance Company | — | — | | — |
| Family Heritage Life Insurance Company of America | 31 | — | 36 | — |
| AILRC | — | 281 | 1,515 | 14,665 |
| AIMS | 2,000 | — | | — |
| | $ 4,610 | $ 1,086 | $ 9,719 | $ 32,856 |

The Company has an investment management agreement with Torchmark wherein the Company is charged a fee based on the total value of the securities managed. Total investment management fees incurred were $5,436 and $4,668 for the years ended December 31, 2018 and 2017, respectively.

The Company has a separate service agreement with Torchmark to provide a wide variety of services, resulting in allocated expense to the Company of $14,748 and $10,764 in 2018 and 2017, respectively. The Torchmark agreement is a master service agreement with the Company and the other insurance affiliates and was approved by the Department. The fee is based on the ratio of certain expenses at the affiliate level to comparable Torchmark consolidated expenses, which is then applied to Torchmark's total operating expenses for the prior year.

The Company has agreed to provide National Income Life Insurance Company (National Income), a subsidiary of the Company, certain legal, actuarial, marketing and other services with respect to National Income's life and accident and health businesses. In 2018 and 2017, the Company charged a fee of $7,529 and $5,400, respectively, for these services. The Company also services the agent balance receivables on behalf of another of its affiliates, American Income Life Insurance Company Receivables Corp (AILRC). In 2018 and 2017, the Company charged AILRC $1,610 and $1,515, respectively, for these services.

During 2018 and 2017, the Company sold agent balances totaling $334,809 and $326,912, respectively, to its affiliate AILRC. The agent balances were sold to AILRC at a discount and amortized through investment expense, a component of investment income, evenly over the life of the agent balances. Amortization expense of $15,607 and $14,665 was recorded in 2018 and 2017, respectively.

**Capital**—The Company owned 19,169 shares of Torchmark 7.15% Cumulative Preferred Stock, Series A and 20,000 shares of Torchmark 6.5% Cumulative Preferred Stock, Series A as of December 31, 2018 and 2017, respectively. The carrying value of the stock was $39,169 as of December 31, 2018 and 2017. The Company received cash dividends of $1,300 for the 6.5% Cumulative Preferred Stock and $1,371 for the 7.15% Cumulative Preferred Stock during 2018 and 2017. The Department limits the Company's carrying value of investment in affiliated preferred stock to 2% of prior year total admitted assets. No amounts were required to be nonadmitted as of December 31, 2018 or 2017.

During 2012, the Company applied for and obtained approval from the Department to issue surplus notes in the aggregate of $50,000. The Company issued a $25,000 par value surplus note to Torchmark on December 31, 2012. The surplus note was issued with an interest rate of 5.25% and a maturity date of December 31, 2042. The carrying value of the surplus note was $25,000, at December 31, 2018 and 2017. Semi-annual interest payments are due in April and October. The surplus note has the following repayment conditions and restrictions: 1) payments of principal and interest can only be made from the issuer's available surplus when the amount of surplus over all liabilities is equal to or greater than the surplus existing immediately after the issuance of the surplus note; and 2) payments can only be made with the prior approval of the Indiana Insurance Commissioner.

The surplus notes are direct, unsecured obligations of the Company. In the event of liquidation, the notes are subordinate to holders of policy claims, other indebtedness, and other creditor claims. The surplus notes were issued pursuant to rule 144A under the securities act of 1933. All proceeds were received in cash. Interest expense accrued as of December 31, 2018 and 2017 was $1,312 and $1,312, respectively. Total interest paid since inception of the note is $7,601.

In 2017, Torchmark sold the $25,000 surplus notes to Globe Life, an affiliate.

**Affiliate Transactions for Current and Prior Years**—In addition to the balances and transactions with affiliates summarized in the table above, the Company also entered into a variety of reinsurance transactions that have been disclosed in Note 4 and borrowing transactions with affiliates that are described below:

The Company borrowed $25,000 and $5,000 at an interest rate of 5.00% and 5.00% on June 18, 2018 and July 27, 2018 from Liberty National Insurance Company, an affiliate of the Company. The borrowings were repaid in full on September 18, 2018 and September 24, 2018, respectively. The Company incurred interest expense of $325 on the borrowings.

The Company borrowed $10,000, $7,000, $10,000, $5,000, and $15,000 at an interest rate of 4.50%, 4.75%, 5.00%, 5.25%, and 5.25% on February 22, April 30, July 3, October 16, and October 29, 2018 from Torchmark Corporation. The borrowings were repaid in full on March 19, May 3, September 20, November 19, and November 16, 2018, respectively. The Company incurred interest expense of $192 on the borrowings.

The Company borrowed $10,000 at an interest rate of 4.50% on February 5, 2018 from United American Insurance Company. The borrowings were repaid in full on April 6, 2018. The Company incurred interest expense of $76 on the borrowings.

American Income Marketing Services Inc., a subsidiary of the Company, borrowed $2,000, $2,000, and $2,000 at an interest rate of 4.25%, 4.75%, and 5.25% from the Company on December 1, 2017, June 1, 2018, and November 30, 2018. The first two borrowings were repaid in full on June 1 and November 30, 2018. The third borrowing has a scheduled maturity date of May 31, 2019.

(Dollar amounts in thousands except for shares)

Family Heritage Life Insurance Company borrowed $3,000 at an interest rate of 4.50% from the Company on March 9, 2018. The borrowing was repaid in full on March 23, 2018.

Liberty National Life Insurance Company borrowed $5,000 and $12,000 at an interest rate of 4.50% and 4.75% from the Company on March 21 and March 27, 2018. The borrowings were repaid in full on May 3, 2018.

Torchmark Corporation borrowed $22,000 at an interest rate of 4.50% from the Company on January 12, 2018. The borrowing was repaid in full on February 9, 2018.

United American Insurance Company borrowed $5,000 at an interest rate of 4.75% from the Company on May 4, 2018. The borrowing was repaid in full on June 26, 2018.

The Company's foreign subsidiary, Union Heritage Life Assurance DAC, was sold on March 9, 2017 for $3,177 at a loss of $7,321.

On December 15, 2017, Globe Life And Accident Insurance Company sold to the Company, all of its rights, title and interest to the 5.25% surplus note issued by Family Heritage Life Insurance Company of America on September 30, 2016, and scheduled to mature on September 30, 2046. The purchase price for the note was $15,174, the note's fair value as of the effective date.

On December 21, 2018, Torchmark Corporation made a capital contribution in the form of transferred assets (software) to American Income Life Insurance Company in the amount of $11,889.

**Non Insurance Investments in Subsidiary, Controlled, and Affiliated Entities (SCA)**—The following tables list SCA for the year ended December 31, 2018:

| SCA Entity | Percentage of SCA Ownership | Gross Amount | Admitted Amount | Nonadmitted Amount |
|---|---|---|---|---|
| (1) Balance Sheet Value (Admitted and Nonadmitted) All SCAs (Except 8bi Entities) | | | | |
| a. SSAP No. 97 8a Entities | | | | |
| 8a entity description | | | | |
| Total SSAP No. 97 8a Entities | XXX | $ — | $ — | $ — |
| b. SSAP No. 97 8b(ii) Entities | | | | |
| 8b(ii) entity description | | | | |
| American Income Marketing Services | 1.0 | 1,203 | — | 1,203 |
| Total SSAP No. 97 8b(ii) Entities | XXX | 1,203 | — | 1,203 |
| c. SSAP No. 97 8b(iii) Entities | | | | |
| 8b(iii) entity description | | | | |
| Total SSAP No. 97 8b(iii) Entities | XXX | — | — | — |
| d. SSAP No. 97 8b(iv) Entities | | | | |
| 8b(iv) entity description | | | | |
| Total SSAP No. 97 8b(iv) Entities | XXX | — | — | — |
| e. SSAP No. 97 8b Entities (except 8b(i) entities) (b+c+d) | XXX | 1,203 | — | 1,203 |
| f. Aggregate Total (a + e) | XXX | $ 1,203 | $ — | $ 1,203 |

(Dollar amounts in thousands except for shares)

| SCA Entity | Type of NAIC Filing * | Date of Filing to the NAIC | NAIC Valuation Amount | NAIC Response Received Y/N | NAIC Disallowed Entities Valuation Method, Resubmission Required Y/N | Code** |
|---|---|---|---|---|---|---|
| (2) NAIC Filing Response Information | | | | | | |
| a. SSAP No. 97 8a Entities | | | | | | |
| 8a entity description | | | | | | |
| Total SSAP No. 97 8a Entities .......... | XXX | XXX | $ — | XXX | XXX | XXX |
| b. SSAP No. 97 8b(ii) Entities | | | | | | |
| 8b(ii) entity description | | | | | | |
| American Income Marketing Services ........................................ | N/A | 0 | — | N/A | N/A | I |
| Total SSAP No. 97 8b(ii) Entities ...... | XXX | XXX | — | XXX | XXX | XXX |
| c. SSAP No. 97 8b(iii) Entities | | | | | | |
| 8b(iii) entity description | | | | | | |
| Total SSAP No. 97 8b(iii) Entities...... | XXX | XXX | — | XXX | XXX | XXX |
| d. SSAP No. 97 8b(iv) Entities | | | | | | |
| 8b(iv) entity description | | | | | | |
| Total SSAP No. 97 8b(iv) Entities ..... | XXX | XXX | — | XXX | XXX | XXX |
| e. SSAP No. 97 8b Entities (except 8b(i) entities) (b+c+d) ...................... | XXX | XXX | — | XXX | XXX | XXX |
| f. Aggregate Total (a + e) ................. | XXX | XXX | $ — | XXX | XXX | XXX |

* S1 - Sub-1, S2 - Sub-2 or RDF - Resubmission of Disallowed Filing

** I - Immaterial or M - Material

## 9. CAPITAL AND SURPLUS AND SHAREHOLDER'S DIVIDEND RESTRICTIONS

The Company has 23,360,214 common shares authorized and 11,680,107 common shares issued outstanding. All shares are Class A shares. The common stock of the Company is wholly-owned by Torchmark.

**Dividends**—The Company declared and paid $143,651 and $123,204 in dividends to Torchmark during the year ended December 31, 2018 and 2017, respectively. The Company paid extraordinary dividends on common stock to Torchmark in 2017 of $70,696. No extraordinary dividends were paid in 2018.

Statutory regulations in the State of Indiana limit the payment of dividends by stock life insurance companies in any one year to an amount equal to the greater of statutory net gain from operations from the previous year or 10% of surplus reported for the previous year. Dividends in excess of these limitations are not available without special approval of the regulatory authorities. The maximum dividend the Company can make without prior approval in 2019 is $191,363.

**Surplus Notes**—The Company had $25,000 in surplus notes outstanding at December 31, 2018 and 2017. Interest expense of $1,312 in both 2018 and 2017 related to these notes is included in the accompanying statutory-basis financial statements. Payments of principal and interest can only be made from the Company's available surplus when the amount of surplus over all liabilities is double that of the amount of principal and interest then being paid. Payments can only be made with the prior approval of the Department. The note is a direct, unsecured obligation of the Company. In the event of liquidation, the note is subordinate to holders of policy claims, other indebtedness and other creditor claims. The entire amount of the note is held by the Company's affiliate, Globe Life. The surplus note was previously owned by the Parent Company, Torchmark.

(Dollar amounts in thousands except for shares)

**Unassigned Surplus**—The portion of unassigned surplus increased or (reduced) by each item below is as follows as of December 31:

| | 2018 | 2017 |
|---|---|---|
| Nonadmitted asset values | $ (36,133) | $ (29,375) |
| Asset valuation reserve | (34,742) | (33,493) |
| Net unrealized gains (losses)—net of tax | (8,156) | (14,811) |

The 2018 and 2017 net unrealized loss as presented above differs from the amount disclosed in the Company's annual statement within note 13.10. The difference is due to net unrealized foreign exchange capital gain, net of tax of $29,666 and $30,895, respectively and less prior year's adjustment of tax on repatriation of $(712). The change in net unrealized foreign exchange capital gains is presented on the Statutory-Basis Statement of Changes in Capital and Surplus.

## 10. COMMITMENTS AND CONTINGENCIES

**Lease Commitments**—Future minimum rental commitments required under operating leases having remaining noncancelable lease terms in excess of one year at December 31, 2018 were as follows:

| | Year Ending December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2019 | 2020 | 2021 | 2022 | 2023 | Total |
| Operating lease commitments .............. | $ 272 | $ 275 | $ 133 | $ 103 | $ — | $ 783 |

Lease expense included in general expenses was $338 and $315 for the years ended December 31, 2018 and 2017, respectively. The Company has the option to renew most of its leases at the end of the lease term at the fair value for a period of five to ten years.

**Litigation**—American Income and its subsidiary, in common with the insurance industry in general, are subject to litigation, including putative class action litigation, alleged breaches of contract, torts, including bad faith and fraud claims based on alleged wrongful or fraudulent acts of agents of American Income and its subsidiary, employment discrimination, and miscellaneous other causes of action. Based upon information presently available, and in light of legal and other factual defenses available to American Income and its subsidiary, management does not believe that it is reasonably possible that such litigation will have a material adverse effect on American Income's financial condition, future operating results or liquidity; however, assessing the eventual outcome of litigation necessarily involves forward-looking speculation as to judgments to be made by judges, juries and appellate courts in the future. This bespeaks caution, particularly in states with reputations for high punitive damage verdicts. American Income's management recognizes that large punitive damage awards bearing little or no relation to actual damages continue to be awarded by juries in jurisdictions in which American Income and its subsidiary have substantial business, creating the potential for unpredictable material adverse judgments in any given punitive damage suit.

During 2018, there were no payments made to settle claims related to extra contractual obligations or bad faith claims stemming from lawsuits. During 2017, the Company paid $612 to settle seven claims related to extra contractual obligations or bad faith claims stemming from lawsuits.

On September 12, 2018, putative class action litigation was filed against American Income Life Insurance Company in California's Contra Costa County Superior Court (Joh v. American Income Life Insurance Company, Case No. C18-01863). An amended complaint was filed on October 18, 2018. American Income removed the case to the United States District Court for the Northern District of California (Case No. 3:18-cv-06364-TSH). The plaintiff, a former insurance sales agent of American Income, is suing on behalf of all current and former sales agents who sold insurance for American Income in the state of California for the four years prior to the filing of the complaint. The amended complaint alleges that such individuals are employees and asserts claims under the California Labor Code, California Business and Professions Code, and California Private Attorney General Act. The complaint seeks compensatory damages, penalties and attorney fees on claims for failure to pay wages/commissions, failure to appropriately pay agents at termination, failure to provide itemized wage statements, failure to reimburse expenses and unfair business practices. The Company continues to assess the amount and thus does not have a reasonable estimate of any potential liability.

On October 18, 2018, putative class action litigation was filed against Torchmark Corporation and American Income Life Insurance Company in California's Los Angeles County Superior Court (Golz v. American Income Life Insurance Company, et al Case No. 18STCV01354). American Income removed the case to the United States District Court for the Central District of California (Case No. 2:18-cv-09879 R (SSx)). An amended complaint was filed on February 5, 2019. The amended complaint alleges that the putative class members are employees and asserts claims under the California Labor Code and California Business and Professions Code. The complaint alleges that plaintiff was an American Income insurance agent trainee in California who seeks to represent a class of individuals in California whom American Income classified as independently contracted agent trainees. The class period is alleged to begin four years prior to the complaint's filing. The complaint seeks compensatory damages, penalties, and attorney fees on claims for failure to pay minimum wage and overtime, failure to provide meal and rest breaks, failure to appropriately pay wages at termination, failure to provide itemized wage statements, failure to reimburse business expenses, and unfair business practices. The Company continues to assess the amount and thus does not have a reasonable estimate of any potential liability.

On December 14, 2018, putative class action litigation was filed against American Income Life Insurance Company in United States District Court for the Northern District of California (Hamilton v. American Income Life Insurance Company, Case No. 4:18-cv-7535-KAW). An amended complaint was filed on January 23, 2019. The plaintiffs, former insurance sales agents of American Income, are suing on behalf of all current and former sales agents who sold insurance for American Income in the state of California for the last four years prior to the filing of the complaint. The lawsuit alleges that putative class members are employees and asserts claims under the California Labor Code, California Business and Professions Code, and California Private Attorney General Act. The complaint seeks compensatory damages, penalties and attorney fees on claims for failure to pay minimum wage and overtime, failure to provide meal and rest breaks, failure to appropriately pay agents at termination, failure to provide itemized wage statements, failure to reimburse expenses, and unfair business practices. The Company continues to assess the amount and thus does not have a reasonable estimate of any potential liability.

On January 16, 2019, putative class action litigation was filed against American Income Life Insurance Company in Orange County, California Superior Court (Putros v. American Income Life Insurance Company, Case No. 30-2019-01044772-CU-OE-CXC). The plaintiff, a former insurance sales agent of American Income, is suing on behalf of all current and former sales agents who sold insurance for American Income in the state of California for the last four years prior to the filing of the complaint. The lawsuit alleges that putative class members are employees and asserts claims under the California Labor Code, California Business and Professions Code, and California Private Attorney General Act. The complaint seeks compensatory damages, penalties and attorney fees on claims for failure to pay minimum wage, failure to provide meal and rest breaks, failure to appropriately pay agents at termination, failure to provide itemized wage statements, failure to reimburse expenses, and unfair business practices. The Company continues to assess the amount and thus does not have a reasonable estimate of any potential liability.

**Unclaimed Property Audits**—The Torchmark insurance subsidiaries are undergoing unclaimed property audits by three separate audit firms covering all but four states. These audits require the subsidiaries to provide the auditors with certain policy data dating back to 1992, which data will be checked against the Social Security Death Master File to determine whether any unclaimed insurance benefits are due. The subsidiaries are currently meeting the deadlines to provide information to the outside audit firms. In a related matter, along with approximately 65 other insurers (including the Company's affiliates), the Company is defending a lawsuit brought by the Treasurer of West Virginia, which lawsuit alleges that the Company failed to identify unclaimed life insurance proceeds and make payments to the Treasurer's Office. The Treasurer agreed to stay the action during the pendency of the Torchmark subsidiaries' on-going unclaimed property audits in West Virginia. No estimate of range can be made at this time for loss contingencies related to possible administrative amounts or penalties that could be payable to the states for the escheatment of abandoned property.

(Dollar amounts in thousands except for shares)

**Guaranty Fund**—On March 1, 2017, the Commonwealth Court of Pennsylvania issued orders placing Penn Treaty and American Network in liquidation. In such instances, the various state guaranty fund associations employ funding mechanisms, through assessments to its member companies, to cover the obligations of the insolvent entities. Consequently, the Company received guaranty fund assessments from some of the state associations. The Company estimated its share of the ultimate loss expected from the insolvency based on assumptions about future events and its market share of premiums by state. In accordance with SSAP No. 35R, *Guaranty Fund and Other Assessments*, a liability has been recorded in the accompanying statutory-basis financial statements. Furthermore, an admitted asset shall be recognized for the amount of the paid or accrued assessment to the extent that is recoverable from premium tax offsets. The Company does not anticipate the assessments will have a material impact on the capital and surplus based on the Company's ability to utilize premium tax credits for substantially all of the estimated charges. The Company has estimated its ultimate unrecoverable assessments related to the liquidation will be $142, which was charged to operations in the prior year.

## 11. ELECTRONIC DATA PROCESSING EQUIPMENT

Electronic data processing equipment (EDP) and operating and non-operating software at December 31, 2018 and 2017, consisted of the following:

| | 2018 | 2017 |
|---|---|---|
| Electronic data processing equipment—net | $ 912 | $ 627 |
| System software—net | 12,408 | 1,091 |
| Balance—net | 13,320 | 1,718 |
| Total nonadmitted | 12,408 | 1,091 |
| Total admitted | $ 912 | $ 627 |

Depreciation expense related to EDP and software totaled $1,509 and $701, for the years ended December 31, 2018 and 2017, respectively. The Company recorded total depreciation of $1,797 and $1,010, in 2018 and 2017, respectively. Total accumulated depreciation for 2018 and 2017 was $1,562 and $1,267, respectively.

(Dollar amounts in thousands except for shares)

## 12. FOREIGN EXCHANGE ADJUSTMENT

The Company is licensed to sell insurance in Canada and New Zealand. Invested assets held in Canada and New Zealand were $320,929 and $308,435 (U.S. dollars) at December 31, 2018 and 2017, respectively. The net foreign exchange adjustments resulting from the translation of assets denominated in foreign currencies was approximately $29,666 and $30,895, at December 31, 2018 and 2017, respectively. The change in this foreign exchange adjustment, net of tax, of $(1,229) and $7,047 for the years ended December 31, 2018 and 2017, respectively, is included in the accompanying statutory-basis statements of changes in capital and surplus.

## 13. PARTICIPATING POLICIES

The Company does not currently write any participating business. The Company accounts for its policyholder dividends on an accrual basis consistent with SSAP No. 51, *Life Contracts* and SSAP No. 54, *Individual and Group Accident and Health Contracts*. The Company incurred dividends in the amount of $12 and $12 to life and annuity policyholders in 2018 and 2017, respectively, and did not allocate any additional income to such policyholders.

## 14. RECONCILIATION TO THE ANNUAL STATEMENT

The accompanying 2018 and 2017 statutory-basis financial statements differ from the amounts shown in the Company's statutory annual statement for 2018 and 2017, respectively.

Following is a reconciliation of account balances as reported to state regulatory authorities to amounts reported herein:

| **Statements of Operations** | **2018** |
|---|---|
| Increase in aggregate reserves for life and accident and health contracts as reported in the Company's annual statement | $ 161,774 |
| Adjustment to reclassify foreign exchange | 25,525 |
| Increase in aggregate reserves for future policy benefits as reported in the accompanying statutory-basis statements of operations | $ 187,299 |
| Foreign Currency Translation Adjustment as reported in the Company's annual statement | $ 25,525 |
| Adjustment to reclassify foreign exchange | (25,525) |
| Foreign Currency Translation Adjustment as reported in the accompanying statutory-basis statements of operations | $ — |

| **Statements of Operations** | **2017** |
|---|---|
| Increase in aggregate reserves for life and accident and health contracts as reported in the Company's annual statement | $ 502,748 |
| Adjustment to reclassify foreign exchange | (18,339) |
| Increase in aggregate reserves for future policy benefits as reported in the accompanying statutory-basis statements of operations | 484,409 |
| Foreign Currency Translation Adjustment as reported in the Company's annual statement | $ (18,339) |
| Adjustment to reclassify foreign exchange | 18,339 |
| Foreign Currency Translation Adjustment as reported in the accompanying statutory-basis statements of operations | $ — |

******

# STATUTORY-BASIS SUPPLEMENTAL SCHEDULES
(See Independent Auditors' Report)

# AMERICAN INCOME LIFE INSURANCE COMPANY

## SUPPLEMENTAL SCHEDULE OF INVESTMENT RISKS INTERROGATORIES
## AS OF DECEMBER 31, 2018
## (Dollar amounts in thousands)

1. The Company's total admitted assets are $4,156,790.

2. Ten largest exposures to a single issue/borrower/investment.

| | Issuer | Description of Exposure | Amount | Percentage of Total Admitted Assets |
|---|---|---|---|---|
| 2.01 | Johnson Controls Intl PLC | Bond | $ 42,627 | 1.0% |
| 2.02 | National Income Life Insurance Company (Affiliate) | Common Stock | $ 40,217 | 1.0% |
| 2.03 | Torchmark Corporation (Affiliate) | Preferred Stock | $ 39,169 | 0.9% |
| 2.04 | Nutrien LTD | Bond | $ 37,047 | 0.9% |
| 2.05 | Vale Overseas Limited | Bond | $ 33,302 | 0.8% |
| 2.06 | Metlife Inc | Bond | $ 26,668 | 0.6% |
| 2.07 | CSX Corporation | Bond | $ 26,048 | 0.6% |
| 2.08 | Canadian Pacific Railroad Company | Bond | $ 25,815 | 0.6% |
| 2.09 | Navient Corporation | Bond | $ 24,990 | 0.6% |
| 2.10 | Simon Property Group LP | Bond | $ 24,695 | 0.6% |

3. Amounts and percentages of the Company's total admitted assets held in bonds and preferred stock by NAIC designation.

| | Bonds | Amount | Percentage | Preferred Stock | Amount | Percentage |
|---|---|---|---|---|---|---|
| 3.01 | NAIC–1 | $ 1,211,262 | 29.1% | P/RP–1 | $ — | —% |
| 3.02 | NAIC–2 | $ 1,961,437 | 47.2% | P/RP–2 | $ 39,169 | 0.9% |
| 3.03 | NAIC–3 | $ 127,932 | 3.1% | P/RP–3 | $ — | —% |
| 3.04 | NAIC–4 | $ 26,817 | 0.6% | P/RP–4 | $ — | —% |
| 3.05 | NAIC–5 | $ 6,000 | 0.1% | P/RP–5 | $ — | —% |
| 3.06 | NAIC–6 | $ — | —% | P/RP–6 | $ — | —% |

(Continued)

## AMERICAN INCOME LIFE INSURANCE COMPANY

**Supplemental Schedules**
**YEAR ENDED DECEMBER 31, 2018**
**Dollar amounts in thousands**

4. Assets held in foreign investments:

| | | | | |
|---|---|---|---|---|
| 4.01 | Are assets held in foreign investments less than 2.5% of the reporting entity's total admitted assets? | | Yes [ ] | No [ X ] |
| 4.02 | Total admitted assets held in foreign investments. | $ | 408,833 | 9.8% |
| 4.03 | Foreign-currency-denominated investments. | $ | 36,788 | 0.9% |
| 4.04 | Insurance liabilities denominated in that same foreign currency. | $ | 34,045 | 0.8% |

5. Aggregate foreign investment exposure categorized by NAIC sovereign designation:

| | | | | |
|---|---|---|---|---|
| 5.01 | Countries designated NAIC–1 | $ | 361,379 | 8.7% |
| 5.02 | Countries designated NAIC–2 | $ | 47,454 | 1.1% |
| 5.03 | Countries designated NAIC–3 or below | $ | — | —% |

6. Largest foreign investment exposures by country, categorized by the country's NAIC sovereign designation:

| | | | | |
|---|---|---|---|---|
| | Countries designated NAIC–1: | | | |
| 6.01 | Country 1: Great Britain | $ | 56,678 | 1.4% |
| 6.02 | Country 2: Netherlands | $ | 51,917 | 1.2% |
| | Countries designated NAIC–2: | | | |
| 6.03 | Country 1: Mexico | $ | 41,572 | 1.0% |
| 6.04 | Country 2: Panama | $ | 5,882 | 0.1% |
| | Countries designated NAIC–3 or below: | | | |
| 6.05 | Country 1: | $ | — | —% |
| 6.06 | Country 2: | $ | — | —% |

| | | | | |
|---|---|---|---|---|
| 7. | Aggregate unhedged foreign currency exposure | $ | 36,788 | 0.9% |

8. Aggregate unhedged foreign currency exposure categorized by NAIC sovereign designation:

| | | | | |
|---|---|---|---|---|
| 8.01 | Countries designated NAIC–1 | $ | 36,788 | 0.9% |
| 8.02 | Countries designated NAIC–2 | $ | — | —% |
| 8.03 | Countries designated NAIC–3 or below | $ | — | —% |

(Continued)

## AMERICAN INCOME LIFE INSURANCE COMPANY

**Supplemental Schedules**
**YEAR ENDED DECEMBER 31, 2018**
**Dollar amounts in thousands**

9. Largest unhedged foreign currency exposures by country, categorized by the country's NAIC sovereign designation:

| | | | | |
|---|---|---|---|---|
| | Countries designated NAIC–1: | | | |
| 9.01 | Country 1: New Zealand | $ | 36,788 | 0.9% |
| 9.02 | Country 2: | $ | — | —% |
| | Countries designated NAIC–2: | | | |
| 9.03 | Country 1: | $ | — | —% |
| 9.04 | Country 2: | $ | — | —% |
| | Countries designated NAIC–3 or below: | | | |
| 9.05 | Country 1: | $ | — | —% |
| 9.06 | Country 2: | $ | — | —% |

10. Ten largest non-sovereign (i.e. non-governmental) foreign issues:

| | Issuer | NAIC Designation | Amount | Percentage |
|---|---|---|---|---|
| 10.01 | Johnson Controls Intl PLC | 2FE | $ 42,627 | 1.0% |
| 10.02 | Vale Overseas Limited | 2FE | $ 33,302 | 0.8% |
| 10.03 | Cooperatieve Rabobank UA | 1FE | $ 20,377 | 0.5% |
| 10.04 | Grupo Bimbo SAB DE CV | 2FE | $ 18,061 | 0.4% |
| 10.05 | Koninklijke Philips NV | 2FE | $ 16,284 | 0.4% |
| 10.06 | AXA SA | 2FE | $ 16,139 | 0.4% |
| 10.07 | Tyco Electronics Group | 1FE | $ 16,040 | 0.4% |
| 10.08 | United Utilities PLC | 2FE | $ 15,356 | 0.4% |
| 10.09 | Electricite De France SA | 1FE | $ 15,105 | 0.4% |
| 10.10 | WWP Finance 2010 | 2FE | $ 14,098 | 0.3% |

11. Amounts and percentages of the reporting entity's total admitted assets held in Canadian investments and unhedged Canadian currency exposure:

| | | | | |
|---|---|---|---|---|
| 11.01 | Are assets held in Canadian investments less than 2.5% of the reporting entity's total admitted assets? | | Yes [ ] | No [ X ] |
| 11.02 | Total admitted assets held in Canadian investments | $ | 459,415 | 11.1% |
| 11.03 | Canadian-currency-denominated investments | $ | 260,520 | 6.3% |
| 11.04 | Canadian-denominated insurance liabilities | $ | 319,573 | 7.7% |
| 11.05 | Unhedged Canadian currency exposure | $ | 260,520 | 6.3% |

12. Report aggregate amounts and percentages of the reporting entity's total admitted assets held in investments with contractual sales restrictions:

| | | | |
|---|---|---|---|
| 12.01 | Are assets held in investments with contractual sales restrictions less than 2.5% of the reporting entity's total admitted assets? | Yes [ X ] | No [ ] |

(Continued)

## AMERICAN INCOME LIFE INSURANCE COMPANY

**Supplemental Schedules**
**YEAR ENDED DECEMBER 31, 2018**
**Dollar amounts in thousands**

13. Amounts and percentages of admitted assets held in the ten largest equity interests:

| | | | | |
|---|---|---|---|---|
| 13.01 | Are assets held in equity interest less than 2.5% of the reporting entities total admitted assets? | | Yes [ ] | No [ X ] |
| | **Issuer** | | | |
| 13.02 | National Income Life Insurance Company (Affiliate) | $ | 40,217 | 1.0% |
| 13.03 | Torchmark Corporation (Affiliate) | $ | 39,169 | 0.9% |
| 13.04 | PIMCO Tatical Opportunities Onshore Fund LP | $ | 24,219 | 0.6% |
| 13.05 | MCGregor Bancshares Inc | $ | 898 | —% |
| 13.06 | The State National Bank | $ | 306 | —% |
| 13.07 | | $ | — | —% |
| 13.08 | | $ | — | —% |
| 13.09 | | $ | — | —% |
| 13.10 | | $ | — | —% |

14. Amounts and percentages of the reporting entity's total admitted assets held in nonaffiliated, privately placed equities:

14.01 Are assets held in nonaffiliated, privately placed equities less than 2.5% of the reporting entity's total admitted assets? Yes [ X ] No [ ]

15. Amounts and percentages of the reporting entity's total admitted assets held in general partnership interests:

15.01 Are assets held in general partnership interests less than 2.5% of the reporting entity's total admitted assets? Yes [ X ] No [ ]

16. Amounts and percentages of the reporting entity's total admitted assets held in mortgage loans:

16.01 Are mortgage loans reported in Schedule B less than 2.5% of the reporting entity's total admitted assets? Yes [ X ] No [ ]

If response to 16.01 above is yes, responses are not required for the remainder of interrogatory 16 and interrogatory 17.

18. Amounts and percentages of the reporting entity's total admitted assets held in each of the five largest investments in real estate.

18.01 Are assets held in real estate reported in less than 2.5% of the reporting entity's total admitted assets? Yes [ X ] No [ ]

19. Report aggregate amounts and percentages of the reporting entity's total admitted assets held in investments held in mezzanine real estate loans.

19.01 Are assets held in investments held in mezzanine real estate less than 2.5% of the reporting entity's total admitted assets? Yes [ X ] No [ ]

Interrogatories 20–23 are not applicable to the Company.

(Concluded)

## AMERICAN INCOME LIFE INSURANCE COMPANY

**SUPPLEMENTAL SUMMARY INVESTMENT SCHEDULE**
**AS OF DECEMBER 31, 2018**
**(Dollar amounts in thousands)**

| INVESTMENT CATAGORIES | Gross Investment Holdings* | Admitted Assets as Reported in the Annual Statement |
|---|---|---|
| Bonds: | | |
| U.S. treasury securities | $ 5,027 | $ 5,027 |
| Non-U.S. government (including Canada, excluding mortgage-backed securities) | 19,006 | 19,006 |
| Securities issued by states, territories, and possessions, and political subdivisions in the U.S.: | | |
| States, territories and possessions general obligations | 9,014 | 9,014 |
| Political subdivisions of states, territories and possessions and political subdivisions general obligations | 58,030 | 58,030 |
| Revenue and assessment obligations | 111,033 | 111,033 |
| Mortgage-backed securities (includes residential and commercial MBS): | | |
| Pass-through securities: | | |
| Issued or guaranteed by GNMA | 51 | 51 |
| Issued or guaranteed by FNMA and FHLMC | 24 | 24 |
| Other debt and other fixed income securities (excluding short-term): | | |
| Unaffiliated domestic securities (includes credit tenant loans and hybrid securities) | 2,282,021 | 2,282,021 |
| Unaffiliated non-U.S. securities (including Canada) | 849,242 | 849,242 |
| Equity interests: | | |
| Preferred stock - affiliated | 39,169 | 39,169 |
| Common stock - affiliated | 40,217 | 40,217 |
| Common stock - unaffiliated | 1,204 | 1,204 |
| Mortgage Loans: | | |
| Commercial loans | 13,767 | 13,767 |
| Real estate investments - property occupied by company | 660 | 660 |
| Contract loans | 198,926 | 198,926 |
| Cash, cash equivalents, and short-term investments | 35,176 | 35,176 |
| Receivables for securities | 4,000 | 4,000 |
| Other invested assets | 150,286 | 150,286 |
| **TOTAL INVESTED ASSETS** | $ 3,816,853 | $ 3,816,853 |

* Gross investment holdings as valued in compliance with NAIC Accounting Practices and Procedures Manual.

## AMERICAN INCOME LIFE INSURANCE COMPANY

### SUPPLEMENTAL SCHEDULE OF SELECTED STATUTORY-BASIS FINANCIAL DATA
### AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2018
### (Dollar amounts in thousands)

| | | |
|---|---|---|
| **INVESTMENT INCOME EARNED:** | | |
| U.S. government bonds | $ | 85 |
| Other bonds - unaffiliated | | 170,834 |
| Preferred stock - affiliated | | 2,671 |
| Common stock - unaffiliated | | 23 |
| Common stock - affiliated | | 9,093 |
| Mortgage loans | | 569 |
| Contract loans | | 15,066 |
| Cash and cash equivalents | | 843 |
| Other invested assets | | 3,714 |
| Aggregate write-ins for investment income | | 240 |
| GROSS INVESTMENT INCOME | $ | 203,138 |
| MORTGAGE LOANS - BOOK VALUE | | |
| Commercial mortgages | $ | 13,767 |
| MORTGAGE LOANS BY STANDING - BOOK VALUE | | |
| Good standing | $ | 13,767 |
| REAL ESTATE OWNED - book value less encumbrances | $ | 660 |
| OTHER LONG TERM ASSETS - statement value | $ | 150,286 |
| BONDS AND STOCK OF PARENT, SUBSIDIARY, AND AFFILIATES — book value: | | |
| Preferred stock | $ | 39,169 |
| Common stock | | 40,217 |
| TOTAL | $ | 79,386 |

(Continued)

## AMERICAN INCOME LIFE INSURANCE COMPANY

**Supplemental Schedules**
**YEAR ENDED DECEMBER 31, 2018**
**Dollar amounts in thousands**

**BONDS AND SHORT-TERM INVESTMENTS BY NAIC DESIGNATION AND MATURITY**

| | | |
|---|---|---|
| Bonds and short-term investments by maturity - statement value: | | |
| Due within one year or less | $ | 40,863 |
| Over 1 year through 5 years | | 165,108 |
| Over 5 years through 10 years | | 426,413 |
| Over 10 years through 20 years | | 981,412 |
| Over 20 years | | 1,719,652 |
| Total by maturity | $ | 3,333,448 |
| Bonds and short-term investments by NAIC designation - statement value: | | |
| NAIC 1 | $ | 1,211,262 |
| NAIC 2 | | 1,961,437 |
| NAIC 3 | | 127,932 |
| NAIC 4 | | 26,817 |
| NAIC 5 | | 6,000 |
| NAIC 6 | | — |
| Total by NAIC designation | $ | 3,333,448 |
| TOTAL BONDS AND SHORT-TERM INVESTMENTS PUBLICLY TRADED | $ | 2,832,356 |
| TOTAL BONDS AND SHORT-TERM INVESTMENTS PRIVATELY PLACED | $ | 501,092 |
| PREFERRED STOCK - statement value | $ | 39,169 |
| COMMON STOCK - market value | $ | 41,421 |
| SHORT-TERM INVESTMENTS | $ | — |
| CASH AND CASH EQUIVALENTS | $ | 35,176 |

(Continued)

## AMERICAN INCOME LIFE INSURANCE COMPANY

**Supplemental Schedules**
**YEAR ENDED DECEMBER 31, 2018**
**Dollar amounts in thousands**

| | |
|---|---|
| LIFE INSURANCE IN FORCE: | |
| Ordinary | $ 41,207,280 |
| Group life | $ 245,518 |
| AMOUNT OF ACCIDENTAL DEATH INSURANCE IN FORCE | |
| UNDER ORDINARY POLICIES | $ 61,088,429 |
| LIFE INSURANCE POLICIES WITH DISABILITY PROVISIONS IN FORCE: | |
| Ordinary | $ 21,128,427 |
| Group | $ 12,106 |
| SUPPLEMENTARY CONTRACTS IN FORCE: | |
| Ordinary - involving life contingencies income payable | $ 12 |
| ANNUITIES - ordinary: | |
| Deferred - fully paid account balance | $ 3,887 |
| Deferred - not fully paid account balance | $ 249,707 |
| ACCIDENT AND HEALTH INSURANCE - premiums in force: | |
| Ordinary | $ 81,283 |
| Group | $ 7,183 |
| DEPOSIT FUNDS AND DIVIDEND ACCUMULATIONS: | |
| Deposit funds - account balance | $ 86,151 |
| Dividend accumulations - account balance | $ 1,270 |
| CLAIM PAYMENTS 2018: | |
| Group accident and health: | |
| 2018 | $ 3,635 |
| 2017 | $ 1,411 |
| 2016 | $ 123 |
| 2015 and prior | $ 147 |
| Other accident and health: | |
| 2018 | $ 9,233 |
| 2017 | $ 5,920 |
| 2016 | $ 746 |
| 2015 and prior | $ 1,128 |

(Concluded)

# American Income Life Insurance Company - New Zealand Branch

Financial Statements as of and for the Year Ended 31 December 2018, and Independent Auditor's Report

**AMERICAN INCOME LIFE INSURANCE COMPANY**
**NEW ZEALAND BRANCH**

TABLE OF CONTENTS

Deloitte.

# Independent Auditor's Report

## To the Shareholder of American Income Life Insurance Company – New Zealand Branch

**Opinion**

We have audited the financial statements of American Income Life Insurance Company – New Zealand Branch (the 'Branch'), which comprise the balance sheet as at 31 December 2018, and the statement of comprehensive income, statement of movements in the home office account and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements, on pages 6 to 27, present fairly, in all material respects, the financial position of the Branch as at 31 December 2018, and its financial performance and cash flows for the year then ended in accordance with New Zealand Equivalents to International Financial Reporting Standards ('NZ IFRS') and International Financial Reporting Standards ('IFRS').

**Basis for opinion**

We conducted our audit in accordance with International Standards on Auditing ('ISAs') and International Standards on Auditing (New Zealand) ('ISAs (NZ)'). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

We are independent of the Branch in accordance with Professional and Ethical Standard 1 (Revised) *Code of Ethics for Assurance Practitioners* issued by the New Zealand Auditing and Assurance Standards Board and the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants*, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

Our firm carries out other assignments for the Branch in the area of other assurance over solvency returns. These services have not impaired our independence as auditor of the Branch. In addition to this, partners and employees of our firm deal with the Branch on normal terms within the ordinary course of trading activities of the business of the Branch. The firm has no other relationship with, or interest in, the Branch.

**Emphasis of matter - branch**

The Branch is part of American Income Life Insurance Company Limited ('the Company'). As described in Note 16, the assets of the Branch, other than those held in custodial fund are legally available for the satisfaction of debts of the entire company, not solely those appearing on the accompanying balance sheet and its debts may result in claims against assets not appearing thereon. Our opinion is not modified in respect of this matter.

**Key audit matters**

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

| Key audit matter | How our audit addressed the key audit matter |
|---|---|
| **Liability for future policy benefits —Underlying assumptions**<br><br>Life insurance contract liabilities is a key audit matter because of the judgment required in making the estimate. Specific actuarial experience is required to evaluate complex and judgmental actuarial methodologies and assumptions.<br><br>As described in Note 15 to the financial statements, management sets assumptions for mortality, morbidity, persistency, and the discount rate in (1) estimating a liability for insurance contracts that will be incurred in the future ("policy liabilities") and (2) determining the discount rate used to calculate the present value of future benefits.<br><br>Assumptions are determined based upon published studies and analysis of Branch specific experience, adjusted for changes in exposure and other relevant factors.<br><br>Given the inherent uncertainty of these assumptions, the development of such assumptions involve especially subjective judgment. | Our audit procedures related to management's judgments regarding the assumptions used in the development of future policy benefits included the following, among others:<br>• We tested the controls over the valuation process.<br>• We performed testing on the completeness and accuracy of the underlying data used in the development of the assumptions as well as in the determination of the liability for future policy benefits.<br>• We evaluated management's selected actuarial assumptions, including testing the accuracy and completeness of the supporting experience studies.<br>• With the assistance of our actuarial specialists, we evaluated management's judgments regarding the assumptions used in the development of future policy benefits including the appropriateness of the valuation methdodoligy<br>• We evaluated whether the assumptions used were consistent with evidence obtained in other areas of the audit. |

**Other information**

The directors are responsible on behalf of the Branch for the other information. The other information comprises the information in the Annual Report that accompanies the financial statements and the audit report.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

Our responsibility is to read the other information and consider whether it is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If so, we are required to report that fact. We have nothing to report in this regard.

**Directors' responsibilities for the financial statements**

The directors are responsible on behalf of the Branch for the preparation and fair presentation of the financial statements in accordance with NZ IFRS and IFRS, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible on behalf of the Branch for assessing the Branch's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Branch or to cease operations, or have no realistic alternative but to do so.

**Auditor's responsibilities for the audit of the financial statements**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs and ISAs (NZ) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the External Reporting Board's website at:

https://www.xrb.govt.nz/standards-for-assurance-practitioners/auditors-responsibilities/audit-report-2

This description forms part of our auditor's report.

**Restriction on use**

This report is made solely to the Branch's shareholders, as a body. Our audit has been undertaken so that we might state to the Branch's shareholders those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Branch's shareholders as a body, for our audit work, for this report, or for the opinions we have formed.

Deloitte Limited

**Mike Hoshek, Partner**
**for Deloitte Limited**
Christchurch, New Zealand
29 April 2019

**AMERICAN INCOME LIFE INSURANCE COMPANY**
**NEW ZEALAND BRANCH**

Financial Statements
As of and for the year ended 31 December 2018

APPROVAL BY DIRECTORS

The directors are pleased to present the financial statements of American Income Life Insurance Company - New Zealand Branch as of and for the year ended 31 December 2018.

The shareholders of the Company have exercised their rights under Section 211(3) of the Companies Act 1993 and unanimously agred that the annual report need not company with any of the Sections (a) and (e) to (j) of Section 211(1) and of Section 211(2) of the Act.

Director

Michael Shane Henrie

For and on behalf of the Directors

Date: 29 April 2019

Director

James Matthew Darden

AMERICAN INCOME LIFE INSURANCE COMPANY
NEW ZEALAND BRANCH

STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES
For the Year Ended 31 December 2018

1. **GENERAL ACCOUNTING POLICIES**

**General Information** - The reporting entity is American Income Life Insurance Company - New Zealand Branch (the "Branch"). American Income Life Insurance Company (the "Company") is registered under the Companies Act 1993.

Effective 31 July 2013, the Company established a statutory fund in accordance with the Insurance (Prudential Supervision) Act 2010 ("IPSA-2010"). Note 16 to the financial statements provides further information in relation to the Statutory Fund. The Company was granted a full license by the Reserve Bank of New Zealand under IPSA-2010 on 23 August 2013. The life insurance operations of the Branch are conducted as required by the IPSA - 2010 and are reported in aggregate in the statement of comprehensive income, balance sheet, statement of cash flows and statement of movements in the home office account of the Branch. The life insurance operations of the Branch comprise the selling and administration of life insurance contracts. All contracts are non-investment linked business. All business written by the Branch is non-participating and all profits and losses are allocated to the statutory fund.

Life insurance contracts involve the acceptance of significant insurance risk. Insurance contracts include those where the insured benefit is payable on the occurrence of a specified event such as death, injury or disability caused by accident or illness.

The principal place of business is American Income Life Insurance Company, 1200 Wooded Acres, Waco, Texas, United States of America. The contact address for the Branch is c/o AIL New Zealand Limited (an independently owned company and independent contractor), AIL House, 2165 Great North Road, Avondale, Auckland, New Zealand.

**Basis of Preparation** - The financial statements presented are those solely for the Branch and are prepared on the basis of historical costs except for certain assets and liabilities as noted. The financial statements comprise statements of the following: significant accounting policies, statement of comprehensive income, statement of movements in the home office account, balance sheet, statement of cash flows, as well as notes to these statements contained on pages 6 to 27.

**Statement of Compliance** - The Branch is a profit-oriented entity and has applied all applicable standards for profit-oriented entities.

The Branch is an FMC reporting entity under the Financial Markets Conduct Act 2013. These financial statements have been prepared in accordance with the requirements of the Financial Markets Conduct Act 2013.

The financial statements have been prepared in accordance with Generally Accepted Accounting Practice in New Zealand (NZ GAAP). They comply with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) and other applicable Financial Reporting Standards as appropriate for profit-oriented entities. The financial statements comply with International Financial Reporting Standards.

**Presentation and Functional Currency of the Branch** - These financial statements have been prepared in New Zealand dollars, which is the functional currency of the branch.

**Overview of Insurance Risk** - The financial assets and liabilities are subject to market and insurance risk and other changes of experience assumptions that may have a material effect on NZ IFRS basis profit or loss and equity. Market risk is the risk that the fair value or future cash flows of a financial instrument, or liability of insurance contracts will vary because of changes in market prices. Market risk involves four types of risk:

*Credit Risk* - is the risk that a counter-party will default on its contractual agreement exposing the Branch to potential financial loss. The Branch manages this risk in accordance with its investment management policies.

*Currency Risk* - is the risk of loss resulting from changes in exchange rate when applied to assets and liabilities or future transactions denominated in a currency that is not the Branch's functional currency. The Branch sets limits for the management of currency risk arising from the Branch's investments based on prudent international asset management practice.

*Interest Rate Risk* - is the risk that the value or future value of cash flows of a financial instrument will fluctuate because of changes in interest rates. The Branch manages interest rate risk arising from its interest bearing investments in accordance with Branch policies.

*Other Price Risk* - is the risk of loss resulting from the decline in prices of equity securities or other assets. The price risk is managed by diversification of the investment portfolio.

Policyholder liabilities and reserves are subject to the effects of changes in experience, or expected future experience, such as for mortality and rates of discontinuance.

**Standards and Interpretations Not Yet Effective** - NZ IFRS 16 "Leases" is effective for balance dates beginning after 1 January 2019. The standard replaces NZ IAS 17. NZ IFRS 16 eliminates the distinction between operating and finance leases for lessees and will result in lessees bringing most leases onto their balance sheets. Management does not expect the adoption of this guidance to have a material impact on the Branch financial statements.

NZ IFRS 17 "Insurance Contracts" is effective for balance dates beginning 1 January 2022. The standard replaces NZ IFRS 4. NZ IFRS 17 requires entities to identify portfolios of insurance contracts which are subject to similar risk and managed together. Each portfolio, at minimum shall be divided into three groups, a group of contracts that are onerous at initial recognition, a group of contracts that at initial recognition have no significant possibility of becoming onerous, and a group of the remaining contracts in the portfolio. The standard measures insurance contracts either under the general model or a simplified version of this called the Premium Allocation Approach. An entity shall apply the standard retrospectively unless impracticable, in which case entities have the option of using either the modified retrospective approach or the fair value approach. Management has yet to perform an analysis to assess the impact of these new standards on the financial statements.

**Adoption of New and Revised Standards and Interpretations** - NZ IFRS 9 “Financial Instruments” is effective for balance dates beginning on or after 1 January 2018. The standard replaces NZ IAS 39. NZ IFRS 9 requires the financial assets to be classified into two measurement categories, being those measured at fair value and those measured at amortised cost. The determination is made when the instruments are initially recognised. The method of classification is dependent on the entity's business model and how it manages its financial instruments. For financial liabilities, the standard maintains most of the requirements set out in NZ IAS 39. NZ IFRS 9 introduces a new expected credit loss ("ECL") model for calculating the impairment of financial assets. No ECL allowance was deemed necessary. The Branch has applied NZ IFRS 9 retrospectively without restating the comparative information for the prior period as permitted by the transitional provisions of the standard.

The adoption of NZ IFRS 9 resulted in no differences between the previous carrying amount of the financial instruments and the carrying amount of those instruments at 1 January 2018.

From a classification perspective, the impact to the Branch was not significant as the majority of the Branch's financial instruments continue to be classified as measured at fair value through profit or loss.

## 2. PARTICULAR ACCOUNTING POLICIES

a) **Recognition of Premium Income and Policy Expenses** - Premiums on life insurance policies are recognised as revenues when received and due. Premiums on accident and health policies are recognised as revenue when due. Unearned premiums on accident and health policies are calculated on a pro rata basis.

Policy acquisition costs are the fixed and variable costs of acquiring new business, including commission. Policy maintenance costs include all operating and management costs other than acquisition and investment management costs.

All expenses that are not directly attributable to the acquisition of life insurance contracts are classified as maintenance expenses.

b) **Investments** - The government and other debt securities are stated at fair values, which were obtained from third party pricing services, with any resultant gain or loss recognised in profit or loss.

c) **Taxation** - Income tax expense represents the sum of the tax currently payable and deferred tax.

*Current Tax* - The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in profit or loss because it excludes items of income or expenses that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Branch's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

*Deferred Tax* - Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences, and deferred tax assets are generally recognised for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilized.

d) **Financial Instruments** - Assets and liabilities of the Branch are primarily financial instruments and are recognised in the Balance Sheet.

The Branch has determined that cash and bonds in the custodial account are the assets held in relation to insurance contracts for backing insurance contract liabilities. The branch has provided additional protection for its New Zealand policy holders by ring-fencing a significant proportion of its financial assets in a trust structure, sufficient to cover it's solvency liabilities in New Zealand.

The accounting policies applying to financial assets held to back life insurance activities are:

Financial assets are stated at fair value, with any resulting gain or loss recognised in profit or loss. All purchases or sales of financial assets carried at fair value through profit or loss that require delivery within the timeframe established by regulation or market convention ("regular way" purchase and sales) are recognised at trade date, which is the date the Company commits to purchase or sell the assets.

Loan and deposits are recognised at settlement date, which is the date that the assets are delivered or received.

Short term deposits and cash and cash equivalents are carried at amortised cost and are recorded using the effective interest method, with revenue recognised on an effective yield basis. The effective interest method is a method of calculating the amortised cost of a financial asset and of allocating interest income over the relevant period. The effective interest rate is that rate that exactly discounts estimated future cash receipts through the expected life of the financial asset, or, where appropriate, a shorter period to the net carrying amount of the financial asset.

Accrued investment income and receivables from affiliates that do not back insurance contract liabilities are measured at amortised cost, less any allowance for ECL. Interest income is recognised by applying the effective interest rate. Receivables from affiliates primarily represent claw back commission, advances to agents and interest accrued on these amounts.

e) **Trade and Other Liabilities** - Trade payables and other liabilities are recognised when the entity becomes obliged to make future payments resulting from the purchase of goods and services and are measured at amortized cost.

f) **Statement of Cash Flows** - The statement of cash flows has been prepared using the direct approach modified by the netting of certain items disclosed below.

Operating activities are the principal revenue producing activities of the Branch and other activities that are not investing or financing activities.

Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash and cash equivalents.

Financing activities are activities that result in changes in the size and composition of the contributed equity and borrowings of the Branch.

Cash and cash equivalents reflect the balance of cash and liquid assets used in the day-to-day cash management.

g) **Impairment of Financial Assets** - Assets measured at fair value through profit or loss are not subject to impairment testing.

The amount of ECLs for financial assets, other than those at fair value through profit or loss, is updated at each reporting date to reflect changes in credit risk since initial recognition.

The Branch applies a simplified approach in calculating ECLs for receivables from affiliates. Therefore, the branch does not track changes in credit risk, but instead recognises a loss allowance based on lifetime ECLs at each reporting dates. Where considered necessary, an ECL has been established and the asset is written down to its estimated recoverable amount.

The Branch applies a general approach in calculating ECLs for accrued investment income. Using the general approach, if the credit risk on a financial instrument has not increased significantly since initial recognition, the Branch is required to measure the loss allowance for that financial instrument at an amount equal to twelve months of ECL.

h) **Policy Liabilities** - Policy liabilities consist of life insurance contract liabilities.

i) ***Life Insurance Contract Liabilities*** **-** The value of life insurance contract liabilities is calculated using the Margin on Services (MoS) methodology in accordance with New Zealand Society of Actuaries Professional Standard 20, *Determination of Life Insurance Policy Liabilities* (PS20). Under this methodology, planned profit margins and an estimate of future liabilities are calculated separately for each related product group using best estimate assumptions at each reporting date, and acquisition costs are deferred over the life of the contract. Profit margins are released over each reporting period in line with the services that have been provided. The balance of the planned profits is deferred by including them in the value of policy liabilities. Further details of the actuarial assumptions used in these calculations are set out in Note 15.

MoS profit can be analysed into the following categories:
(i) *Planned Margins of Revenues over Expenses* - At the time of writing a policy and at each balance date, best estimate assumptions are used to determine all expected future payments and premiums. Where actual experience replicates best estimate assumptions, the expected profit margin will be released to profit over the life of the policy.
(ii) *The Difference Between Actual and Assumed Experience* - Experience profits/(losses) are realized where actual experience differs from best estimate assumptions. Instances giving rise to experience profits/(losses) include variations in claims, expenses, mortality, discontinuance and investment returns. For

example, an experience profit will emerge when the expenses of maintaining all in-forcebusiness in a year are lower than the best estimate assumption in respect of those expenses.

(iii) *Changes to Underlying Assumptions* - The financial statement effect of all changes to underlying assumptions used for measuring policy liabilities are reviewed each year. Where the review leads to a change in assumptions, the change is deemed to have occurred from the end of the year, except for changes in discount rates which are recognised in the year that the rates are changed.
The financial effect of all other changes to the assumptions underlying the measurement of policy liabilities made during the reporting period is recognised in profit or loss over the future reporting periods during which services are provided to policyholders.

(iv) *Loss Recognition on Groups of Related Products* - If based on best estimate assumptions, written business for a group of related products is expected to be unprofitable, the total expected loss for that related product group is recognised in profit or loss immediately. When loss-making business becomes profitable, it is necessary to reverse previously recognised losses.

(v) *Investment Earnings on Assets in Excess of Policy Liabilities* - Profits are generated from investment assets, which are in excess of those required to meet policy liabilities. Investment earnings are directly influenced by market conditions and as such this component of MoS profit will vary from year to year.

## 3. SIGNIFICANT JUDGMENTS, ESTIMATES, AND ASSUMPTIONS

In the application of NZ IFRS management is required to make judgments, estimates and assumptions about the carrying values of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and various other factors that we believe to be reasonable under the circumstances, the results of which form the basis of making the judgments. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Significant judgments, estimates and assumptions made by management in the preparation of these financial statements are outlined below:

a) **Estimation of Insurance Contract Liabilities** - Insurance contract liabilities for life insurance contracts are computed using statistical or mathematical methods. The computations are made by suitably qualified personnel on the basis of recognised actuarial methods, with due regard to relevant actuarial principles. The methodology takes into account the risks and uncertainties of the particular classes of life insurance business written. Deferred policy acquisition costs are connected with the measurement basis of life insurance liabilities and are equally sensitive to the factors that are considered in the liability measurement.

The key factors that affect the estimation of these liabilities and related assets are:

- Mortality and morbidity experience on life insurance products, including enhancements to policyholder benefits;
- Discontinuance experience, which affects the Branch's ability to recover the cost of acquiring new business over the lives of the contracts;
- The cost of providing benefits and administering these insurance contracts;
- The discount rate applied to calculate the present value of future benefits;

In addition, factors such as regulation, inflation, interest rates, taxes, investment market conditions and general economic conditions affect the level of these liabilities. Refer to Note 15 for disclosure of assumptions.

**Policy and Contract Claims** - Policy and contract claims include provisions for reported claims and claims incurred but not reported. The provision for claims incurred but not reported is estimated based on the Branch's experience.

Since this liability is based on estimates, the ultimate settlement of losses may vary from the amounts included in the financial statements. Although it is not possible to measure the degree of variability inherent in such estimates, the Branch believes the liability for claims is reasonable.

**AMERICAN INCOME LIFE INSURANCE COMPANY**
**NEW ZEALAND BRANCH**

STATEMENT OF COMPREHENSIVE INCOME
For the Year Ended 31 December 2018

| | 2018 | 2017 |
|---|---|---|
| INCOME: | | |
| Premiums (Note 1) | $ 22,296,277 | $ 22,572,609 |
| Interest income on investments (Note 2) | 2,086,129 | 1,607,964 |
| Unrealized surplus (deficit) on revaluation of debt security investments to fair value | 794,749 | 1,307,542 |
| Other interest | 712,369 | 757,112 |
| | 25,889,524 | 26,245,227 |
| EXPENDITURE: | | |
| Claims (Note 3) | 5,191,398 | 5,528,032 |
| Change in liability for future policy benefits (Note 15) | 9,150,193 | 8,287,909 |
| Commissions (Note 4) | 6,393,620 | 6,104,540 |
| Management expenses (Note 5) | 4,356,865 | 3,581,837 |
| | 25,092,076 | 23,502,318 |
| PROFIT BEFORE TAXATION | 797,448 | 2,742,909 |
| TAXATION (Note 13) | (98,319) | (353,210) |
| PROFIT AFTER TAXATION ATTRIBUTABLE TO HEAD OFFICE (Note 6) | $ 895,767 | $ 3,096,119 |
| TOTAL COMPREHENSIVE PROFIT | $ 895,767 | $ 3,096,119 |

The Statements of Significant Accounting Policies and Notes to the Financial Statements form part of, and should be read in conjunction with, these financial statements.

**AMERICAN INCOME LIFE INSURANCE COMPANY**
**NEW ZEALAND BRANCH**

STATEMENT OF MOVEMENTS IN THE HOME OFFICE ACCOUNT
For the Year Ended 31 December 2018

| | 2018 | 2017 |
|---|---|---|
| BALANCE — Beginning of the year | $ 63,761,383 | $ 72,803,893 |
| Contributions from the home office: | | |
| General advances (Note 9) received / (made) | (9,503,743) | (14,499,785) |
| Expenses paid on behalf of the Branch (Note 9) | 3,019,491 | 2,361,156 |
| | (6,484,252) | (12,138,629) |
| Income after tax | 895,767 | 3,096,119 |
| Total comprehensive income | 895,767 | 3,096,119 |
| BALANCE — End of the year | $ 58,172,897 | $ 63,761,383 |

The Statements of Significant Accounting Policies and Notes to the Financial Statements form part of, and should be read in conjunction with, these financial statements.

**AMERICAN INCOME LIFE INSURANCE COMPANY**
**NEW ZEALAND BRANCH**

BALANCE SHEET
As of 31 December 2018

| | 2018 | 2017 |
|---|---|---|
| **ASSETS** | | |
| CASH AND CASH EQUIVALENTS | $ 9,382,788 | $ 21,640,708 |
| INVESTMENTS (Note 8) | 58,037,390 | 40,732,159 |
| POLICY LOANS | 3,507,902 | 3,021,339 |
| OUTSTANDING PREMIUMS | 159,717 | 117,163 |
| ACCRUED INVESTMENT INCOME | 703,119 | 565,631 |
| RECEIVABLE FROM AFFILIATES | 8,703,035 | 9,704,556 |
| PREPAYMENTS | 817 | 1,458,704 |
| TOTAL | $ 80,494,768 | $ 77,240,260 |
| **LIABILITIES AND HOME OFFICE ACCOUNT** | | |
| POLICY AND CONTRACT CLAIMS | $ 1,523,798 | $ 1,681,370 |
| UNEARNED PREMIUMS | 37,505 | 39,036 |
| TRADE AND OTHER LIABILITIES | 957,456 | 802,329 |
| NET RESERVE FOR FUTURE POLICY BENEFITS (Note 15) | 19,430,216 | 10,280,023 |
| CURRENT TAX LIABILITIES (Note 13) | 372,896 | 676,119 |
| Total liabilities | 22,321,871 | 13,478,877 |
| ADVANCES FROM HOME OFFICE (Note 9) | 21,907,401 | 28,391,652 |
| ACCUMULATED SURPLUS | 36,265,496 | 35,369,731 |
| Total home office account | 58,172,897 | 63,761,383 |
| TOTAL | $ 80,494,768 | $ 77,240,260 |

The Statements of Significant Accounting Policies and Notes to the Financial Statements form part of, and should be read in conjunction with, these financial statements.

**AMERICAN INCOME LIFE INSURANCE COMPANY**
**NEW ZEALAND BRANCH**

STATEMENT OF CASH FLOWS
For the Year Ended 31 December 2018

| | 2018 | 2017 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Premiums and other considerations received from policyholders | $ 21,767,160 | $ 22,139,948 |
| Interest income | 2,182,656 | 1,730,621 |
| Other interest | 712,369 | 757,112 |
| Payment of claims | (5,350,501) | (5,609,302) |
| Payments of taxes | (204,904) | (182,658) |
| Payments of commissions | (5,392,099) | (4,753,335) |
| Payments to suppliers, agents etc. | 771,897 | (1,097,762) |
| Net cash provided by operating activities (Note 12) | 14,486,578 | 12,984,624 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Cash paid for long term investments | (16,744,498) | (3,956,114) |
| Net cash (used) in investing activities | (16,744,498) | (3,956,114) |
| CASH FLOWS FROM FINANCING ACTIVITIES — Advances provided by / (repaid to) related parties | (10,000,000) | (15,000,000) |
| Net cash (used) in financing activities | (10,000,000) | (15,000,000) |
| NET (DECREASE)/INCREASE IN CASH ON HAND | (12,257,920) | (5,971,490) |
| CASH ON HAND — Beginning of year | 21,640,708 | 27,612,198 |
| CASH ON HAND — End of year | $ 9,382,788 | $ 21,640,708 |

The Statements of Significant Accounting Policies and Notes to the Financial Statements form part of, and should be read in conjunction with, these financial statements.

**AMERICAN INCOME LIFE INSURANCE COMPANY**
**NEW ZEALAND BRANCH**

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended 31 December 2018

## 1. PREMIUMS

| | | 2018 | | 2017 |
|---|---|---|---|---|
| Individual life | $ | 18,511,125 | | 18,975,646 |
| Accident and health | | 3,785,152 | | 3,596,963 |
| | $ | 22,296,277 | $ | 22,572,609 |

## 2. INTEREST INCOME ON INVESTMENTS

| | | 2018 | | 2017 |
|---|---|---|---|---|
| Government securities | $ | 1,154,538 | | 1,162,179 |
| Other debt securities | | 931,591 | | 445,785 |
| | $ | 2,086,129 | $ | 1,607,964 |

## 3. CLAIMS

| | | 2018 | | 2017 |
|---|---|---|---|---|
| Individual life | $ | 4,159,699 | $ | 4,288,671 |
| Accident and health | | 1,031,699 | | 1,239,361 |
| | $ | 5,191,398 | $ | 5,528,032 |

## 4. COMMISSIONS (POLICY ACQUISITION EXPENSES)

| | | 2018 | | 2017 |
|---|---|---|---|---|
| In respect of new policies: | | | | |
| Individual life - First Year | $ | 3,267,043 | $ | 2,984,693 |
| Individual life - Renewal | | 2,319,582 | | 2,429,531 |
| Accident and health - First Year | | 420,264 | | 293,212 |
| Accident and health - Renewal | | 386,731 | | 397,104 |
| | $ | 6,393,620 | $ | 6,104,540 |

## 5. MANAGEMENT EXPENSES

| | 2018 | 2017 |
|---|---|---|
| Home office charges: | | |
| General expenses | $ 1,123,049 | $ 871,375 |
| Salaries | 1,896,443 | 1,489,780 |
| General office expenses | 631,255 | 802,981 |
| Remuneration for services provided: | | |
| Audit and assurance fees paid to Deloitte | 131,121 | 162,341 |
| Taxation Services - Other firms | 37,449 | 117,113 |
| Other expenses | 517,764 | 117,412 |
| Investment expenses | 19,785 | 20,385 |
| | $ 4,356,865 | $ 3,581,387 |

## 6. PROFIT AFTER TAX

The profit for the year has arisen as follows:

| | 2018 | 2017 |
|---|---|---|
| Planned margins | $ 2,615,291 | $ 2,473,664 |
| Actual and assumed experience | 1,714,424 | 2,449,782 |
| Basis change* | (6,135,888) | (5,131,782) |
| Investment earnings on assets in excess of policy liabilities | 2,701,940 | 3,304,454 |
| | $ 895,767 | $ 3,096,119 |

* The basis change is the impact of changes to the discount rates used in valuation of policy liabilities.

## CAPITAL COMMITMENTS

7. There are no commitments for capital expenditure entered into at 31 December 2018 and 2017.

## 8. INVESTMENTS

| | 2018 | 2017 |
|---|---|---|
| Bonds | | |
| Governments | $ 28,571,893 | $ 28,522,994 |
| Corporates | 29,465,497 | 12,209,165 |
| Total Bonds | $ 58,037,390 | $ 40,732,159 |

These securities mature from 2021 to 2028 and carry an effective yield of approximately 4.34% (2017 - 4.39%).

## 9. RELATED PARTY TRANSACTIONS

American Income Life Insurance Company incurs expenses for the Branch at the Home Office in Waco, Texas. Those expenses, as well as additional start-up costs are shown as advances from the Home Office to the Branch. Additionally, there are no members of management located at the branch in New Zealand, therefore the Home Office bears the cost of management. The advance payable to the Home Office as at 31 December 2018 was $21,907,401 (2017: $28,391,652). The total value of these expenses for the year were $3,019,491 (2017: $2,361,156) and a general advance was paid during the year of $(9,503,743) (2017: $(14,499,785)). These amounts are repayable on demand, however the Home Office has no plans to demand settlement in the next 12 months. The advance has no priorities attached and is interest free to the Branch.

## 10. LOANS TO DIRECTORS OR EMPLOYEES

None (2017: Nil)

## 11. FINANCIAL INSTRUMENTS

The financial condition and operating results of the Branch are affected by a number of financial and non-financial risks. Financial risks include interest rate risk, credit risk, and liquidity risk. Non-financial risks include insurance risks.

The Branch's objective is to prudently manage these risks.

Financial risks are managed via a conservative investment management strategy, with assets concentrated in liquid, investment grade bonds. The asset mix includes medium-term investments in government securities, aimed at immunizing the policy liabilities against interest rate fluctuations.

Insurance risks are managed via prudent underwriting of new business applications from prospective policyholders and via thorough selection of appropriate sales staff to act as the Branch's intermediaries.

**Insurance Risks** - Terms and conditions that affect the timing of cash-flows

The Branch's products are predominantly long-term policies providing death and disablement benefits. The policy liabilities are calculated on the basis that the assumed rate of investment returns are able to be realized on policy reserves and on net cash-flows in future. If these returns are not achieved then the projected surpluses will be lower than expected.

The Branch's products provide death and disablement benefits that are significantly in excess of the policy liabilities. Consequently if claim levels are higher than expected then the projected surpluses will be lower than expected.

The Branch's products provide surrender values on product cancellation, and if more clients surrender than expected then the projected cash out-flows will be accelerated.

The policy liabilities are based on the assumption that policies are able to be maintained for a certain level of administration costs. If these costs are exceeded there will be a resulting reduction in emerging profits.

The Branch does not write any group business, where there could be concentrations of lives insured in one work-place.

The total individual Life and Accident and Hospital claims paid in 2018 for claims incurred before 2018 is $968,416 which is lower by $706,339 compared to claim liabilities estimate of $1,674,755 provided in 2017.

Insurance risk can be quantified by showing the sensitivity of policy liabilities and future profit margins to changes in the main assumptions that affect insurance business risks. The table below shows the impact of variations to assumptions concerning discount rates, the major types of claims, policy discontinuances and administration costs.

**2018**

| | Life | | Life (Accident & Hospital Indemnity) | |
|---|---|---|---|---|
| **Assumption variation** | **Policy Liabilities** | **Margins** | **Policy Liabilities** | **Margins** |
| Discount rate 1% higher | $ (9,932,300) | $ (1,522,735) | $ (208,807) | $ (341,389) |
| Discount rate 1% lower | 14,428,820 | 1,835,455 | 327,777 | 410,321 |
| Deaths and disablements 10% higher | | (5,471,744) | | (1,610,335) |
| Deaths and disablements 10% lower | | 5,841,561 | | 1,610,988 |
| Annual surrenders 10% higher | | 994,591 | | 18,976 |
| Annual surrenders 10% lower | | (1,212,645) | | (45,061) |
| Administration costs 10% higher | | (1,774,516) | | (321,728) |
| Administration costs 10% lower | | 1,774,516 | | 321,728 |

**2017**

| | Life | | Life (Accident & Hospital Indemnity) | |
|---|---|---|---|---|
| **Assumption variation** | **Policy Liabilities** | **Margins** | **Policy Liabilities** | **Margins** |
| Discount rate 1% higher | $ (7,650,766) | $ (1,369,699) | $ (408,344) | $ (145,360) |
| Discount rate 1% lower | 11,136,645 | 1,638,278 | 613,249 | 172,784 |
| Deaths and disablements 10% higher | | (4,915,779) | | (1,735,404) |
| Deaths and disablements 10% lower | | 5,222,213 | | 1,736,556 |
| Annual surrenders 10% higher | | 398,139 | | 122,043 |
| Annual surrenders 10% lower | | (550,018) | | (187,649) |
| Administration costs 10% higher | | (1,669,932) | | (354,203) |
| Administration costs 10% lower | | 1,669,932 | | 354,203 |

**Interest Rate Risk** - Invested assets are subject to the customary risks of defaults, downgrades, and changes in market values. Factors that may affect these risks include interest rate levels, financial market performance, and general economic conditions. Significant increases in interest rates could cause a material temporary decline in the fair value of the fixed investment portfolio, reflecting unrealized fair value losses. This risk is mitigated by the Branch's operating strategy to generally hold investments to maturity recognizing the long-term nature of the life policy reserve liabilities supported by investments. The high credit quality of investments held, which are all NZ Government direct obligations and bonds of NZ agencies, municipals and corporates (refer to Note 8), greatly diminishes the need to liquidate investments prior to maturity.

The following table illustrates the market risk sensitivity of our interest-rate sensitive fixed-maturity portfolio at 31 December 2018 and 2017. This table measures the effect of a change in interest rates on the profit or loss and equity of the Branch. The data measures the effect on profit or loss and equity arising from an immediate and sustained change in interest rates in increments of 100 basis points.

| | | Increase (Decrease) in Profit and Equity For the Year | |
|---|---|---|---|
| | | 2018 | 2017 |
| Change in interest rate (bps): | | | |
| | -200 | $ 5,923,275 | $ 4,543,029 |
| | -100 | 2,865,075 | 2,192,704 |
| | 0 | | |
| | +100 | (2,686,608) | (2,047,610) |
| | +200 | (5,208,124) | (3,961,514) |

**Credit Risk** - The Branch's major categories of asset comprise the following:

Investments in government securities, corporate bonds, and registered banks total $67.4 million as of 31 December 2018 (2017 - $62.4 million).

Receivables from affiliates of $8.7 million (2017 - $9.7 million) represent unexpensed agent commissions, which have been purchased from an affiliated party and have not been settled. The recoverability of unexpensed commissions depends on the continuation of the policies on which the commissions have been accrued. The recoverability of clawback amounts will be affected by whether the agent continues to write new business with the Branch, and whether the agent has assets that are able to contribute to any commission recovery.

Outstanding premiums and receivables from affiliates are relatively illiquid assets and are subject to a degree of credit risk. The risk is monitored by management for collectability and an expected credit loss is established as necessary.

Accrued investment income of $0.7 million (2017: $0.5 million) represent interest income earned on the investment portfolio but not yet received as of the balance sheet date.

Accrued investment income represents interest income earned on the investment portfolio but not yet received as of the balance sheet date. This asset category is subject to a degree of credit risk. In assessing whether the credit risk has increased significantly since initial recognition, the Branch continually monitors the economic and credit status of each of its bond holdings and analyzes each issuer's ability to continue meeting its contractual debt obligations. Factors taken into consideration include:

- An actual or expected significant deterioration in the issuer's credit rating
- Existing or projected changes to the business, economic, financial, or regulatory environment under which the issuer operates that could adversely impact its ability to meet its debt obligations
- Actual or projected deterioration in operating results that could significantly impact the issuer's cash flows and thus, its ability to meet debt obligations
- Changes to, or removal of, financial guarantees from a third-party guarantor
- Actual or projected deterioration in any underlying collateral
- News and information, either released by the issuer or otherwise reported by the media or securities analysts who monitor the issuer, that indicate the issuer is unlikely to pay its creditors on time or in full

When, based upon the assessments above, it is determined that a contractual interest payment will not be received or is not expected to be received, the accrued interest receivable will be reversed through investment income. Since all of the bonds held by the Branch are obligated to pay interest either semi-annually or quarterly, the collectability of such interest is determinable at regular intervals throughout the year.

The Branch does not have any significant credit risk exposure to any single counter-party or any group of counter-parties having similar characteristics.

**Liquidity Risk** - The Branch maintains adequate cash and short-term investments on an ongoing basis to meet anticipated liquidity needs. Long term securities are NZ government and corporate securities which are readily marketable in the event of unforeseen extraordinary liquidity needs.

The Branch's government long-term securities mature from 2021 through 2028.

The average term of the Branch's liabilities for notified and unnotified claims, unearned premiums, premium taxes, and trade liabilities, totalling $2.5 million, is less than 12 months.

The average term of the Branch's policy liabilities is in excess of five years. Annual claim payments are expected to exceed $1 million per year, however these claims are expected to be met out of projected future net cash-flows, and policy liabilities are projected to increase rather than reduce over the next five years.

**Fair Values** - The Branch measures the fair value of its financial assets based on a hierarchy of three levels that indicate the quality of the fair value measurements as described below:

- Level 1 - fair values are based on quoted prices in active markets for identical assets or liabilities that the Branch has the ability to access as of the measurement date.

- Level 2 - fair values are based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability, or inputs that can otherwise be corroborated by observable market data.

- Level 3 - fair values are based on inputs that are considered unobservable where there is little, if any, market activity for the asset or liability as of the measurement date. In this circumstance, the Branch has to rely on values derived by independent brokers or internally-developed assumptions. Unobservable inputs are developed based on the best information available to the Company which may include the Branch's own data or bid and ask prices in the dealer market.

All of the fair values reported at 31 December 2018 were determined using data provided by third-party pricing services. Prices provided by third-party services are not binding offers but are estimated exit values. They are based on observable market data inputs which can vary by security type. Such inputs include benchmark yields, available trades, broker/ dealer quotes, issuer spreads, benchmark securities, bids, offers and other market data.

As part of the Branch's controls over pricing, management reviews and analyzes all prices obtained to insure the reasonableness of the values, taking all available information into account. One very important control is the corroboration of prices obtained from third-party sources against other independent sources. When corroborated prices produce small variations, the close correlation indicates observable inputs, and the median value of the available prices is used as the Branch's final valuation. When corroborated prices present greater variations, additional analysis is required to determine which value is the most appropriate. When one price is available, management evaluates observable inputs and performs additional analysis to confirm that the price is appropriate. All fair value measurements based on prices determined with observable market data are reported as Level 1 or Level 2 measurements. As of 31 December 2018 and 2017, all securities were classified as Level 2.

Fair value measurements at 31 December 2018

| Description | Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total Fair Value |
|---|---|---|---|---|
| Bonds: Fair Value through | | | | |
| Profit and Loss | | | | |
| Governments | $ — | $ 28,571,893 | $ — | $ 28,571,893 |
| Corporates | — | 29,465,497 | — | 29,465,497 |
| Total Bonds | $ — | $ 58,037,390 | $ — | $ 58,037,390 |

Fair value measurements at 31 December 2017

| Description | Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total Fair Value |
|---|---|---|---|---|
| Bonds: Fair Value through | | | | |
| Profit and Loss | | | | |
| Governments | $ — | $ 28,522,994 | $ — | $ 28,522,994 |
| Corporates | — | 12,209,165 | — | 12,209,165 |
| Total Bonds | $ — | $ 40,732,159 | $ — | $ 40,732,159 |

## 12. RECONCILIATION OF NET CASH FLOW FROM OPERATING ACTIVITIES TO OPERATING SURPLUS AFTER TAXATION

| | 2018 | 2017 |
|---|---|---|
| Operating surplus after taxation | $ 895,767 | $ 3,096,119 |
| Add (less) non cash items: | | |
| Change in reserve for future policy benefits | 9,150,193 | 8,287,909 |
| Expenses and general advances paid on behalf of the Branch | 3,515,748 | 2,861,372 |
| Unrealized fair value change | (794,749) | (1,307,542) |
| Change in current and deferred taxes | (113,568) | (346,561) |
| Other | 234,018 | 174,105 |
| Total non cash items | 11,991,642 | 9,669,283 |
| | 12,887,409 | 12,765,402 |
| Movements in working capital: | | |
| Decrease in receivables from affiliates | 1,001,521 | 1,351,205 |
| Increase in accrued investment income | (137,488) | (51,445) |
| Increase in policy loans | (486,563) | (418,868) |
| Decrease in outstanding premiums | (42,554) | (13,793) |
| Decrease in prepayments | 1,457,887 | 54 |
| Increase in policy claims and unearned premiums | (159,103) | (81,270) |
| Change in premium taxes due | — | — |
| Decrease in other liabilities | 155,126 | (377,355) |
| Change in current tax liability | (189,655) | (189,306) |
| | 1,599,171 | 219,222 |
| Net cash provided by operating activities | $ 14,486,578 | $ 12,984,624 |

## 13. INCOME TAXES

| | 2018 | 2017 |
|---|---|---|
| Income taxes: | | |
| Current tax expense/(benefit) | $ 216,590 | $ 199,451 |
| Deferred tax expense/(benefit) | (277,497) | (364,424) |
| Prior period adjustment | (37,412) | (188,237) |
| Total expense | $ (98,319) | $ (353,210) |

The income tax expense on pre-tax accounting profit from operations reconciles to the income tax expense in the financial statements as follows:

| | 2018 | 2017 |
|---|---|---|
| Profit before taxation | $ 797,448 | $ 2,742,909 |
| Income tax expense calculated at 28% in 2018 and 2017 | $ 223,285 | $ 768,014 |
| Effect of life insurance business - shareholder gain on savings business | 319,738 | 371,122 |
| Effect of non-life insurance business - non-deductible claims and commissions and other non-taxable items | (283,293) | (203,256) |
| Current year losses utilized against policyholder base | (137,355) | (191,452) |
| Schedular income permanent differences | (527,289) | (445,734) |
| Tax rate difference on schedular income | (418,540) | (451,276) |
| Unused losses not recognised as deferred tax assets | 762,547 | — |
| Prior period adjustment | (37,412) | (188,236) |
| Policyholder base loss/(profit) not recognized | — | (12,392) |
| Income tax expense | $ (98,319) | $ (353,210) |

| | 2018 | 2017 |
|---|---|---|
| Deferred tax balances: | | |
| Deferred tax asset comprise — tax losses | $ 12,593,667 | $ 12,031,149 |
| Deferred tax liability comprise — net reserve for future policy benefits | (12,623,513) | (12,365,149) |
| Other | 29,846 | 19,091 |
| Net deferred tax balance | $ — | $ (314,909) |

**Unrecognised Deferred Tax Balances** - The following deferred tax assets have not been brought to account as assets:

| | 2018 | 2017 |
|---|---|---|
| Shareholder base: | | |
| Losses | $ 2,723,382 | $ — |
| Tax effect at 28% | 762,547 | — |

The availability of the income tax losses is subject to statutory (including minimum shareholder continuity) requirements being met.

| **Income Tax Payable** | 2018 | 2017 |
|---|---|---|
| Opening balance | $ (361,210) | $ (340,864) |
| Prior period adjustment | — | (3,552) |
| Provisional tax paid | 204,904 | 182,658 |
| Current year charge | (216,590) | (199,451) |
| Total income tax payable for the year | $ (372,896) | $ (361,210) |

## 14. CONTROLLING ENTITIES

The controlling entity of American Income Life Insurance Company is Torchmark Corporation, a Company incorporated in the U.S.A

## 15. ACTUARY'S STATEMENT

The effective date of the actuarial report on policy liabilities and reserves is 31 December 2018. The actuarial policy liabilities and reserves were calculated by Mr. John O. Norton, FSA, of American Income Life Insurance Company.

Mr. Peter Davies of Davies Financial and Actuarial Services, a Fellow of the New Zealand Society of Actuaries, has certified that the amount of policy liabilities has been determined in accordance with Professional Standard No. 20 of the New Zealand Society of Actuaries. The actuarial report was prepared by Mr. Peter Davies.

The actuary is satisfied as to the nature, sufficiency, and accuracy of the data from which the policy liabilities have been determined.

| | 2018 | 2017 |
|---|---|---|
| Policy liabilities: | | |
| Balance at beginning of year | $ 10,280,023 | $ 1,992,114 |
| Movement in current year | 9,150,193 | 8,287,909 |
| Net reserve for future policy benefits | $ 19,430,216 | $ 10,280,023 |

Policy liabilities comprises the following:

| | 2018 | 2017 |
|---|---|---|
| Value of future claims | $ 134,402,522 | $ 119,603,321 |
| Value of future expenses | 41,652,793 | 36,314,776 |
| Value of future profit margins | 20,783,460 | 17,802,156 |
| Less value of future premiums | (177,408,559) | (163,440,230) |
| Net reserve for future policy benefits | $ 19,430,216 | $ 10,280,023 |

The actuary has performed a liability adequacy test in accordance with NZ IFRS 4 and is satisfied as to the accuracy of the data using the assumptions below.

**Disclosure of Assumptions** - Policy liabilities were computed using a projection approach. Two separate projections were created for the Life business, Life plans and Accident and Hospital Indemnity plans.

*Discount Rate* - The 2018 discount rates are based on 31 December 2018 annual risk-free forward rates published by New Zealand Treasury. The 2017 discount rates are based on 31 December 2017 annual risk-free forward rates published by New Zealand Treasury.

*Profit Carrier* - The premium payable under each contract is the profit carrier. Future profits equal approximately 11.6% of the value of future premiums for Life plans and 12.4% of the value of future premiums for Accident & Hospital Indemnity plans.

*Initial Expenses* - For Life plans, 38% of issued premium plus 20% of first year commission. For Accident & Hospital Indemnity plans, 38% of premium.

*Management Expenses* - For Life plans, $35 per policy per annum plus 3% of premium. For Accident & Hospital Indemnity plans, $10 per policy per annum plus 13% of premium. These expenses are inclusive of maintenance, other and investment management expenses presented in Note 5. The rate of inflation is assumed to be 2%, applied to per policy expense.

All calculations have been computed gross of tax, with a deferred tax liability held in respect of the difference between published policy liabilities and policy tax reserves.

*Mortality Rates* - The mortality rates are based on 2001 VBT table with applicable factors.

*Morbidity* - The morbidity rates for 2009 issues and below have multiple factors ranging from 105% to 140%. The morbidity rates for issues 2010 and after are updated based on recent experience study.

*Rates of Discontinuance* - Variable scales per expected portfolio experience. The Life plans and Accident & Hospital plans discontinuance rates were updated based on recent experience study.

*Surrender Values* - All Whole Life plans except "Permanent Life" plans have surrender values which are guaranteed upon issue and expressed in terms of unit of coverage. The surrender values are tabular and were calculated upon issue based on certain non-forfeiture interest rates, non-forfeiture factors and mortality tables.

The impact of change in discount rate on future profit margin is $0.8 million. The impact of change in demographic and expense assumptions on future profit margin is $1.7 million.

Sensitivity analyses for other assumptions were performed (refer to Note 11).

## 16. SOLVENCY

The solvency position has been calculated in accordance with the Reserve Bank of New Zealand (RBNZ) Solvency Standard for Life Insurance Business 2014, issued under the Insurance (Prudential Supervision) Act 2010, effective up to and including 31 December 2018.

| | 2018 | | | 2017 | | |
|---|---|---|---|---|---|---|
| | Custodial Fund | Other | Total Statutory Fund | Custodial Fund | Other | Total Statutory Fund |
| Actual Solvency Capital | $ 42,546,588 | $ 15,626,308 | $ 58,172,896 | $ 32,461,109 | $ 31,300,274 | $ 63,761,383 |
| Minimum Solvency Capital | 29,196,027 | 8,726,025 | 37,922,052 | 12,475,018 | 10,377,718 | 22,852,736 |
| Solvency Margin | $ 13,350,561 | $ 6,900,283 | $ 20,250,844 | $ 19,986,091 | $ 20,922,556 | $ 40,908,647 |
| Solvency Ratio | 146% | 179% | 153% | 260% | 302% | 279% |

Assets held in the Custodial Fund are only available to meet the liabilities of American Income Life Insurance Company - New Zealand Branch. Assets held in the Other Account are legally available for the satisfaction of debts of the American Income Life Insurance Company, not solely those appearing on the balance sheet of the branch and its debts may result in claims against assets not appearing thereon.

## 17. CONTINGENT LIABILITIES

There are no contingent liabilities at 31 December 2018 and 2017.

## 18. New Zealand custody account

Assets (Cash and Securities) in the amount of $64.9 million (2017 - $45.9 million) are held in the Public Trust Custody account. This balance is sufficient to meet the solvency requirements set forth in ISPA 2010.

## 19. CREDIT RATING

American Income Life Insurance Company has an A+ credit rating from AM Best.

Davies Financial and Actuarial Limited

24th April 2019

To: The Directors
American Income Life Insurance Company

From: Peter Davies
Consulting Actuary

**Re: American Income Life Insurance Company: Report as at 31st December 2018 under Sections 77 and 78 of the Insurance (Prudential Supervision) Act 2010**

You have asked me to prepare this report in terms of the above sections of the Act, and I would like to comment further as follows:

1. The American Income Life Insurance Company is a USA-based company registered in the State of Indiana.

   The Company operates a branch in New Zealand, for which I am the Appointed Actuary.

   I have provided a separate Section 78 report in respect of the branch.

2. The Company is required to lodge its own accounts with the New Zealand Companies Office, and these accounts are required to be accompanied by a Section 78 report.

Level 1, Building I, 61 Constellation Drive, Mairangi Bay, Auckland 0652 Telephone (09) 489-3551 e-mail: pdavies@actuary.co.nz
P.O. Box 35-258, Browns Bay, Auckland 0753 Facsimile: (09) 489-6613 home page: www.actuary.co.nz

3. I note that the company's actuarial valuation has been carried out by Mr. Alan B. McLemore, Appointed Actuary, and a Fellow of the Society of Actuaries and a Member of the American Academy of Actuaries.

   I have been provided with a set of the Company's accounts, and with Mr. McLemore's actuarial memorandum in relation to his valuation as at 31st December 2018.

   I note that the Company's accounts include the following information (2017 figures shown in brackets):

| | | |
|---|---|---|
| Statutory Balance sheet Capital: | US$342,970,610 | ($270,338,204) |
| NAIC RBC* Capital calculation: | US$379,050,686 | ($304,919,967) |
| Risk Based capital Requirement: | US$54,727,147 | ($ 48,764,209) |
| Solvency coverage ratio: | 693% | (625%) |

   * National Association of Insurance Commissioners Risk Based Capital

4. I have reviewed the actuarial information included in the audited accounts for American Income Life Insurance Company as at 31st December 2018. "Actuarial information" includes the following:

   - policy liabilities;
   - balance sheet and other information allowed for in the calculation of the company's solvency position; and
   - disclosures regarding the methodology and assumptions used for calculating policy liabilities, and other disclosures.

5. No limitations have been placed on my work.

6. I am independent with respect to American Income Life Insurance Company as defined under professional standard ISA (NZ) 620 of the External Reporting Board.

7. I have been provided with all information that I have requested in order to carry out this review.

8. In my view the actuarial information contained in the financial statements has been appropriately included, and the actuarial information used in the preparation of the financial statements has been appropriately used.

9. In 2013, the Company established a Statutory Fund in New Zealand in terms of the Insurance (Prudential Supervision) Act, and set up a Custodial account within this Fund, under a local trustee arrangement, holding investment assets for the preferential benefit of New Zealand policyholders.

10. Technically, the Company's license requires the Company itself to demonstrate its solvency in terms of the Insurance (Prudential Supervision) Act 2010. This calculation has not been carried out, although clearly the Company is in a strong financial position as assessed by the regulators in the USA.

    I would anticipate however that the New Zealand regulators will still maintain an ongoing active interest in the financial position of the Company, as assessed by the Insurance Commissioner of Indiana.

I would be very happy to answer any queries concerning this report.

Yours sincerely

Peter

Peter Davies B.Bus.Sc., FIA, FNZSA
Appointed Actuary

Davies Financial and Actuarial Limited

24th April 2019

To: The Directors
American Income Life Insurance Company

From: Peter Davies
Consulting Actuary

**Re: American Income Life Insurance Company - New Zealand Branch: Report as at 31st December 2018 under Sections 77 and 78 of the Insurance (Prudential Supervision) Act 2010**

You have asked me to prepare this report in terms of the above sections of the Act, and I would like to comment further as follows:

1. I have reviewed the actuarial information included in the audited accounts for American Income Life Insurance Company – New Zealand Branch as at 31st December 2018. "Actuarial information" includes the following:

    - policy liabilities;
    - solvency calculations in terms of the RBNZ Solvency Standard;
    - balance sheet and other information allowed for in the calculation of the company's solvency position; and
    - disclosures regarding the methodology and assumptions used for calculating policy liabilities, and other disclosures.

2. No limitations have been placed on my work.

Level 1, Building 1, 61 Constellation Drive, Mairangi Bay, Auckland 0652 Telephone (09) 489-3551 e-mail: pdavies@actuary.co.nz
P.O. Box 35-258, Browns Bay, Auckland 0753 Facsimile: (09) 489-6613 home page: www.actuary.co.nz

3. I am independent with respect to American Income Life Insurance Company as defined under professional standard ISA (NZ) 620 of the External Reporting Board.

4. I have been provided with all information that I have requested in order to carry out this review.

5. In my view the actuarial information contained in the financial statements has been appropriately included, and the actuarial information used in the preparation of the financial statements has been appropriately used.

6. During 2013, the Company set up a Statutory Fund in terms of the Insurance (Prudential Supervision) Act. It also established a Custodial account within the Statutory Fund, under a local trustee structure, holding investment assets for the preferential benefit of New Zealand policyholders. The assets of the Custodial account have to be sufficient to meet the RBNZ's solvency requirements in respect of New Zealand policyholders.

The Branch's solvency positions under the RBNZ Standard for Life Insurers as at 31st December were as follows:

| | December 2018 | | | December 2017 | | |
|---|---|---|---|---|---|---|
| | Custodial Fund | Other | Total Statutory Fund | Custodial Fund | Other | Total Statutory Fund |
| Actual Solvency Capital | 42,546,588 | 15,626,308 | 58,172,896 | 32,461,109 | 31,300,274 | 63,761,383 |
| Minimum Solvency Capital | 29,196,027 | 8,726,025 | 37,922,052 | 12,475,018 | 10,377,718 | 22,852,736 |
| Solvency Margin | 13,350,561 | 6,900,283 | 20,250,844 | 19,986,091 | 20,922,556 | 40,908,647 |
| Solvency Ratio | 145.7% | 179.1% | 153.4% | 260.2% | 301.6% | 279.0% |

Assuming the Branch is able to achieve its business plans, the Branch is expected to meet the RBNZ solvency requirement at all times over the next four years.

Level 1, Building 1, 61 Constellation Drive, Mairangi Bay, Auckland 0652
P.O. Box 35-258, Browns Bay, Auckland 0753
Telephone (09) 489-3551
Facsimile: (09) 489-6613
e-mail: pdavies@actuary.co.nz
home page: www.actuary.co.nz

I would be very happy to answer any queries concerning this report.

Yours sincerely

Peter

Peter Davies B.Bus.Sc., FIA, FNZSA
Appointed Actuary

Level 1, Building 1, 61 Constellation Drive, Mairangi Bay, Auckland 0652
P.O. Box 35-258, Browns Bay, Auckland 0753
Telephone (09) 489-3551
Facsimile: (09) 489-6613
e-mail: pdavies@actuary.co.nz
home page: www.actuary.co.nz